


Department's then-current fiscal reporting period, commencing with the reporting period ended June 30, 1997, and to provide notices of the occurrence of certain enumerated events, if material. The Master Continuing Disclosure Undertaking requires that the Annual Financial Information be filed by the Department with the Trustee, with the State information depository (the "SID"), if any, and with each nationally recognized municipal securities information repository (each, a "NRMSIR"). The Master Continuing Disclosure Undertaking requires that notices of material events be filed by the Department with the Trustee, with the SID and with either of each NRMSIR or the Municipal Securities Rulemaking Board. The specific nature of the information to be contained in the Annual Financial Information or the notices of material events is summarized in APPENDIX C - "SUMMARY OF CERTAIN PROVISIONS OF THE MASTER CONTINUING DISCLOSURE UNDERTAKING." These covenants have been made in order to assist the Underwriters in complying with Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission (the "Rule"). The Department has never failed to comply in all material respects with any previous undertakings with respect to the Rule to provide annual financial information or notices of material events.

MISCELLANEOUS

The information set forth herein is subject to change without notice and no implication should be derived therefrom or from the sale of the Offered Revenue Bonds that there has been no change in the affairs of the Department after the date hereof. The distribution of this Official Statement has been duly authorized by the Department. Any statement in this Official Statement involving matters of opinion, whether or not expressly so stated, is intended as such, and not as a representation of fact. Concurrently with the delivery of the Offered Revenue Bonds, the Department will furnish a certificate to the effect that this Official Statement, as of its date and as of the date of delivery of the Offered Revenue Bonds, does not and will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements herein, in the light of the circumstances under which they were made, not misleading. The agreement of the Department with the holders of the Offered Revenue Bonds is set forth in the Resolution. This Official Statement is not to be construed as an agreement or contract between the Department and the purchaser or holder of any of the Offered Revenue Bonds. Additional information may be obtained from the Department at 1227 "O" Street, Sacramento, California 95814, Attention: Bond Finance Division.

DEPARTMENT OF VETERANS AFFAIRS
OF THE STATE OF CALIFORNIA


By: /s/ Bruce Thiesen
Secretary

Dated: November 29, 2001

In the opinion of Bond Counsel as described herein, (i) interest on the Offered Revenue Bonds (as defined below) is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is exempt from State of California personal income taxes, and (ii) interest on the Offered Revenue Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. See "TAX MATTERS" herein.



\$117,200,000

**Department of Veterans Affairs of the State of California
Home Purchase Revenue Bonds
2002 Series A (Non-AMT)**

Dated: Date of Delivery

Due: As set forth below

The 2002 Series A Bonds referred to above (the "Offered Revenue Bonds") will be issued as fully-registered bonds in denominations of \$5,000 or any integral multiple thereof in book-entry form.

Interest on the Offered Revenue Bonds is payable on June 1 and December 1 of each year, commencing June 1, 2002.

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES OR YIELDS, AND CUSIPS

\$39,880,000 5.30% 2002 Series A Term Bonds due December 1, 2021 @ 100%, CUSIP No. 130658HY6

\$77,320,000 5.35% 2002 Series A Term Bonds due December 1, 2027 @ 100%, CUSIP No. 130658HZ3

The Offered Revenue Bonds are subject to redemption prior to maturity, including redemption at par, as described herein.

The Offered Revenue Bonds are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of (i) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund") (other than proceeds of Veterans G.O. Bonds, as defined herein, and amounts in any Rebate Account), (ii) the Bond Reserve Account and (iii) the Loan Loss Account. The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation bonds under any general obligation veterans bond act. **The Department has no taxing power. Neither the faith and credit nor the taxing power of the State of California or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.**

Payment of the principal of and interest on the Offered Revenue Bonds when due will be insured by a financial guaranty insurance policy, to be issued by Ambac Assurance Corporation simultaneously with the delivery of the Offered Revenue Bonds. See "THE FINANCIAL GUARANTY INSURANCE POLICY."

Ambac

This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Offered Revenue Bonds are offered when, as and if issued and delivered to the Underwriters, subject to the approval of legality by The Honorable Bill Lockyer, Attorney General of the State of California, and by Hawkins, Delafield & Wood, Bond Counsel to the Department. Certain legal matters will be passed on by Quateman & Zidell LLP, Disclosure Counsel to the State, and for the Underwriters by their counsel, Kutak Rock LLP. CSG Advisors Incorporated has served as Pricing Advisor in connection with the issuance of the Offered Revenue Bonds. It is expected that the Offered Revenue Bonds in book-entry form will be available for delivery at the offices of The Depository Trust Company on or about March 6, 2002.

**Honorable Philip Angelides
Treasurer of the State of California**

Bear, Stearns & Co. Inc.

**Lehman Brothers
First Albany Corporation
Morgan Stanley & Co. Incorporated
Roberts & Ryan Investments Inc.**

**Great Pacific Securities, Inc.
M.R. Beal & Company
Salomon Smith Barney
Sutro & Co. Incorporated**

**Merrill Lynch & Co.
Mischler Financial Group, Inc.
Pacific American Securities, LLC
Siebert Brandford Shank & Co., LLC**

STATE OF CALIFORNIA

Gray Davis, Governor

DEPARTMENT OF VETERANS AFFAIRS

Bruce Thiesen
Secretary

Gerald Rucker
Undersecretary

Sheryl A. Schmidt
Deputy Secretary

Joseph Maguire
Deputy Secretary/Chief
Counsel of Legal Affairs

George Flores
Chief, Farm and Home Purchases Division

John M. Hanretty
Chief, Financial Services Division

Kandis L. Mendonsa
Chief, Bond Finance Division

**VETERANS' DEBENTURE FINANCE COMMITTEE
AND VETERANS FINANCE COMMITTEE OF 1943**

Gray Davis, Governor

Philip Angelides
State Treasurer

Kathleen Connell
State Controller

Tim Gage
Director of Finance

Bruce Thiesen
Secretary of Veterans Affairs

CALIFORNIA VETERANS BOARD

George G. Sinopoli, Chairman

John L. Fitzke, Vice Chairman

Jerry B. Basconcillo

Pedro Carrillo

Dr. Edward M. Feldman

Judy H. Gaze

Larry S. Laffman

CALIFORNIA STATE TREASURER'S OFFICE

Philip Angelides, State Treasurer
(as Trustee and as Agent for Sale)

ATTORNEY GENERAL OF THE STATE OF CALIFORNIA

Bill Lockyer, Attorney General

BOND COUNSEL

Hawkins, Delafield & Wood

DISCLOSURE COUNSEL

Quateman & Zidell LLP

QUANTITATIVE CONSULTANT

cfX Incorporated

PRICING ADVISOR

CSG Advisors Incorporated

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No dealer, broker, salesman or other person has been authorized by the Department of Veterans Affairs or the Underwriters to give any information or to make any representations with respect to the Department of Veterans Affairs or its Offered Revenue Bonds other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources which are believed to be current and reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Department of Veterans Affairs since the date hereof.

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE OFFERED REVENUE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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OFFICIAL STATEMENT
of
DEPARTMENT OF VETERANS AFFAIRS
OF THE STATE OF CALIFORNIA
RELATING TO
\$117,200,000
HOME PURCHASE REVENUE BONDS
2002 SERIES A (Non-AMT)

INTRODUCTION

This Official Statement is being furnished to provide information in connection with the sale of the Department of Veterans Affairs of the State of California (the "Department") Home Purchase Revenue Bonds, 2002 Series A (the "Offered Revenue Bonds").

The Offered Revenue Bonds are being issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended (the "Act"), constituting Chapter 7 of Division 4 of the Military and Veterans Code (the "Veterans Code") of the State of California (the "State"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Original Resolution"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997, as amended (the "Eighth Supplemental Resolution"), and (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to Resolution No. RB-1, adopted February 24, 1999 (the "Tenth Supplemental Resolution"). The Offered Revenue Bonds are also being issued pursuant to a separate additional authorizing Series Resolution. The Original Resolution, as amended and supplemented by the Eighth Supplemental Resolution and the Tenth Supplemental Resolution, is referred to as "Resolution RB-1," and Resolution RB-1 and the Series Resolution authorizing the issuance of the Offered Revenue Bonds are collectively referred to herein as the "Resolution." The State Treasurer is trustee for the Revenue Bonds (as defined below) pursuant to Resolution RB-1 (the "Trustee").

Ambac Assurance Corporation (the "Insurer") has made a commitment to issue a financial guaranty insurance policy (the "Financial Guaranty Insurance Policy") with respect to the Offered Revenue Bonds, a copy of the form of which is attached as APPENDIX H. The Financial Guaranty Insurance Policy is not a source of payment for and does not provide security for any Revenue Bonds other than the Offered Revenue Bonds. See "THE FINANCIAL GUARANTY INSURANCE POLICY."

The Department has previously issued under Resolution RB-1 its 1997 Series A Bonds, 1997 Series B Bonds and 1997 Series C Bonds, its 1998 Series A Bonds, its 1999 Series A Bonds, its 1999 Series B Bonds, its 2000 Series A Bonds, its 2000 Series B Bonds, its 2000 Series C Bonds, and its 2001 Series A Bonds (the "Prior Revenue Bonds"). The outstanding Prior Revenue Bonds, the Offered Revenue Bonds, and the bonds of any additional series issued under Resolution

RB-1 ("Additional Revenue Bonds") are secured on a parity basis (except for bonds which are subordinate obligations as expressly provided in Resolution RB-1 or in a Series Resolution) and are collectively called the "Revenue Bonds."

Revenue Bonds, including the Offered Revenue Bonds, are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund") other than proceeds of Veterans G.O. Bonds (defined below) and any amounts in any Rebate Account, (ii) the Bond Reserve Account, and (iii) the Loan Loss Account. The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State and of the holders of general obligation bonds issued by the Department under any and all present and future veterans general obligation bond acts (collectively the "Veterans G.O. Bonds"). See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS." **The Department has no taxing power. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.**

Under the Department's Farm and Home Purchase Program (the "Program"), the Department acquires residential property to be sold to eligible veterans under contracts of purchase between the Department and such veterans ("Contracts of Purchase"). Such acquisitions are financed principally with the proceeds of bonds, including Veterans G.O. Bonds and Revenue Bonds.

See "PLAN OF FINANCE" for a discussion of the uses of the proceeds of the Offered Revenue Bonds.

All capitalized terms used in this Official Statement and not defined herein shall have the meanings set forth in the Resolution. See "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION - Definitions (Section 103)."

PLAN OF FINANCE

General

The plan of finance described under this heading is with respect to the Offered Revenue Bonds and the \$111,325,000 Veterans G.O. Bonds, Series BY and Series BZ, expected to be issued on or about December 6, 2001 (the "Winter 2001 Veterans G.O. Bonds") and assumes the issuance of such bonds. The Offered Revenue Bonds are being issued for the purpose of refunding certain optionally redeemable Revenue Bonds with bonds of significantly later maturity, thereby making the funds that would otherwise be utilized to pay such refunded bonds at future maturity dates available to finance Contracts of Purchase. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of money expected to be made available to finance Contracts of Purchase upon the issuance of the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds. Also see "ESTIMATED APPLICATION OF OFFERED REVENUE BOND PROCEEDS." The Winter 2001 Veterans G.O. Bonds are being issued for the purposes of refunding certain outstanding Veterans G.O. Bonds and replacing and refunding certain other

outstanding Veterans G.O. Bonds on their maturity dates, one consequence of which is that some moneys will become available to finance new Contracts of Purchase between the Department and eligible veterans. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS – General," "– The 1943 Fund," and "– Cash Flow Statements and Program Operating Procedures." Also see APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds" for information about Revenue Bonds and Veterans G.O. Bonds expected to be refunded.

The Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds are separate bond issues, although they are treated as a single issue for certain Federal tax purposes. The sales and issuances of the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds are separate and independent. The Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds will each be offered and sold pursuant to a separate official statement, copies of which, when available, can be obtained from the Department.

THE DEPARTMENT

General

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to provide eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members appointed by the Governor, subject to Senate confirmation, for respective terms of four years. All of the members of the Board must be veterans, one member must be retired from the active or reserve forces of the United States military service, one member must have substantial training or expertise in mortgage lending and real estate finance, one member must have substantial training or expertise in geriatrics, gerontology, or long-term care, and one member must be a resident of one of the California veterans homes run by the Department established for qualified aged and disabled veterans and their spouses.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

The Office of Inspector General for Veterans Affairs was created by statute in 1999, and in 2000 the Governor appointed and the Senate confirmed the appointment of an Inspector General for Veterans Affairs. The Inspector General is subject to the direction of the Governor, and is to provide ongoing and independent advice to the Board regarding any issue under Board consideration. The Inspector General is responsible for reviewing and reporting on the operations and financial condition of all veterans programs supported by the State, which include the

Program. The Inspector General is required to submit an annual report to the Board and to the State Legislature, which is to include any recommendations for improving the operations of veterans programs, including the Program.

Administration

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the properties to be acquired under the Program. This includes examinations as to the qualification of veterans to participate in the Program, a credit analysis for each applicant, appraisals of properties and the initial processing of the veterans' applications for Contracts of Purchase.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows mortgage brokers to originate Contracts of Purchase. All Contracts of Purchase are serviced by the Department. Effective July 1, 1999 the Department began utilizing its new Integrated Loan Processing and Financial Information System for origination and servicing of all new Contracts of Purchase. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of September 30, 2001, the Department had a staff of approximately 234 persons in support of the Program.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor, and must be a veteran.

Bruce Thiesen

Secretary of Veterans Affairs since November 2001

Secretary Thiesen is a Vietnam-era Army veteran with a long history as a veterans' activist. In January 1999, Mr. Thiesen was appointed Deputy Secretary for Operations of the Department, and was appointed Interim Secretary of Veterans Affairs in May 2000. Mr. Thiesen has more than 30 years of broad experience as an independent agribusinessman in farm management, farm labor acquisition and benefits administration. Mr. Thiesen served as National Commander of the American Legion in 1993-1994 and from 1995 through 1998 he was appointed by the Secretary of the United States Department of Veterans Affairs as a member of the Veterans Advisory Committee on Rehabilitation. In addition to his work on behalf of veterans, Mr. Thiesen is involved in a number of other community and philanthropic efforts.

Gerald Rucker

Undersecretary since December 1999

Mr. Rucker brings a 30-year history of California State management to the Department. Recent experience includes eight years as Chief of Veterans Services Division and State Service Officer for the Department. From May 1999 to December 1999 Mr. Rucker served as Senior

Assistant to the Secretary of the Department. Prior to joining the Department management team in 1991, he held a variety of management posts with the Departments of Social Services and Rehabilitation. These positions included Personnel Management and Loma Prieta Earthquake Disaster Recovery Team manager, as well as assignments with fiscal information technology and systems development responsibility. Mr. Rucker is a service-connected disabled veteran who served with the 1st Cavalry Division in Vietnam, including combat action during the TET Offensive of 1968, and is a member of the Veterans of Foreign Wars and Disabled American Veterans.

Sheryl A. Schmidt

Deputy Secretary since November 1996

After leaving the accounting firm of Touche Ross (now known as Deloitte & Touche LLP) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force veteran Sheryl Schmidt as the Deputy Secretary of Women Veterans Affairs. Ms. Schmidt also provides administrative oversight over the Information Systems Division and Business Services. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University, Sacramento, and a CPA license from the California State Board of Accountancy.

John M. Hanretty

Chief, Financial Services Division since October 1999

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget Manager. Mr. Hanretty served as the Budget Officer for the Department from August 1998 until December 1999 and was appointed Chief, Financial Services Division in September 1999. He has continuously served on community non-profit boards of directors during his professional career.

George Flores

Chief, Farm and Home Purchases Division since May 1999

Mr. Flores has been with the Department for 24 years. He has served as Manager of the Title and Escrow Unit, Headquarters Operation Manager, Southern Regional Manager and the Assistant Division Chief. He has held the position of Farm and Home Division Chief for two years. He is a United States Army veteran who was graduated from California State University, Sacramento, in 1973 with a Bachelor's of Science degree in Business Administration, and he attended the McGeorge School of Law, University of the Pacific, Sacramento.

Kandis L. Mendonsa
Chief, Bond Finance Division since May 1998

Ms. Mendonsa brings to her current position more than a quarter century of service in California State government. For most of that time, she has worked exclusively in the area of financial management. Prior to joining the Department in 1998, Ms. Mendonsa was employed for 10 years by the Department of Social Services and for 12 years at the State Department of Corrections. While at Corrections, among Ms. Mendonsa's responsibilities was the management of a \$4 billion tax exempt bond program for the construction of youth and adult correction facilities.

Joseph Maguire
Deputy Secretary/Chief Counsel of Legal Affairs since January 2001

Mr. Maguire received a bachelor's degree in business administration from American University in Washington, D.C. in 1967. He then served two years in the U.S. Army. After leaving the military, he worked in the private sector for several years as a franchise business consultant. He then taught mathematics and science in the Philadelphia Public School System while earning a master's degree in education at Temple University in Philadelphia, Pa. In 1976, Mr. Maguire began attending McGeorge School of Law while teaching science and mathematics at Sacramento Country Day School in Sacramento. After graduating in 1980, Mr. Maguire practiced business law for one year as an associate with a private law firm. Mr. Maguire then became a supervisor and senior trial prosecutor. In January 2001, Governor Davis appointed Mr. Maguire to the position of Deputy Secretary/Chief Counsel for Legal Affairs of the Department.

External Reviews of the Program

The Program has been the subject of several external reviews by the executive and legislative branches of State government. A summary of certain of these reviews is presented below.

The Legislative Analyst's Office of the State of California

The Legislative Analyst's Office of the State of California (the "LAO"), issued a 1998 report entitled "Rethinking the Cal-Vet Loan Program" (the "1998 Report"), and an analysis of the then-proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department (the "1999 Report" and, together with the 1998 Report, the "1998/99 LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the 1998/99 LAO Reports, the LAO analyzed the historical and recent financial performance and lending activities of the Department and made various recommendations. The 1998/99 LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The 1998/99 LAO Reports were issued before the impact of the Department's recent programmatic changes had been realized.

In his proposed budget for Fiscal Year 1999-2000, Governor Davis listed several steps intended to improve the operation of State programs for veterans. Those most relevant to the Program are (a) appointment of an inspector general or internal auditor for the Department (which has occurred), (b) a request to the Bureau of State Audits (the "BSA") to conduct a fiscal and program compliance audit of the Program (which also has occurred and is discussed below), and (c) direction to the Secretary of Veterans Affairs to report to the Governor on the need for further restructuring of the Program and on ways that the "surplus funds in the home program" might be redirected to other pressing needs of veterans. As directed, the Department submitted a report to the Governor which, among other things, advised the Governor that, in its view, there are no "surplus" funds in the home program as the term implies. No new gubernatorial directives have been issued to the Department.

On February 17, 2000, the LAO issued an analysis of the proposed Governor's Budget for Fiscal Year 2000-01, which analysis included a discussion of the Department. The report recognized that the administrative costs of the Program are not part of the State budget, but recommended that the Department report to the State Legislature during budget hearings on the reasons for certain cost increases and the steps it is taking to reduce such costs. The LAO did not address the Program, Veterans G.O. Bonds, Revenue Bonds, or the 1943 Fund (defined below) in its reports on the Governor's Budget for Fiscal Year 2001-2002.

Bureau of State Audits

On January 5, 2000, the Legislature directed the BSA to conduct an audit of the California Veterans Farm and Home Loan Purchase Program (loan program). The legislative request called for assessment of, among other things, whether the Department achieves its mission with its loan programs, the financial condition of the loan program and the reasonableness and appropriateness of expenditures, the relationship of the Department's lending standards to those in the lending industry and whether those standards are adhered to in the Department's lending process, and the demographics of eligible war veterans and the impact thereof on the loan program's viability.

On May 25, 2000, the BSA released an audit report concluding that the loan program will substantially lose its ability to offer low-cost home loans to veterans beyond the next decade due to the restrictive eligibility requirements attributed to certain program funding and the limited availability of other funding sources. The BSA further concluded that the Department was eroding loan program funds due to insufficient budget controls, inefficient and inconsistent loan operations and by charges to the loan program for unrelated administrative positions and costs. Finally, the BSA concluded, based in part upon its conclusion that the Department's testing of its integrated information system was incomplete, that the Department will need to spend more time and money to ensure that its integrated information system provides necessary, reliable program and financial information.

In a written response to the May 25, 2000 report, the Department disagreed with certain conclusions of the BSA and expressed the belief that it has already addressed certain report findings. In particular, the Department projects that the loan program will be attractive to a much higher percentage of eligible veterans than estimated by the BSA. Further, the Department believes that additional loan sources can be created through additional allocations of Qualified Mortgage Bonds loans and the blending of Unrestricted Moneys (as defined herein) tax-exempt bonds with taxable bonds. In addition, the Department contends that steps have already been taken to ensure that information systems are properly administered and that loan program data and

assets are adequately safeguarded. As part of the Department's plan to implement corrective action in certain areas identified by the BSA, the Department, upon the recommendations of an outside consultant, has undertaken steps designed to ensure proper allocation of its direct and indirect administrative costs to the loan program.

On March 28, 2001, the BSA released an audit report prepared in response to the Legislature's direction for an audit of the Department's life and disability insurance program. In its report, the BSA concluded that changes made to the Department's life and disability insurance program in 1996 reduced the Department's financial liabilities but also reduced the insurance program's benefits for veterans. The analysis in the audit report divides the Department's insurance program into two principal parts: the self-funded plan and the commercial plan. The self-funded plan is closed to new participants and covers veterans who were disabled when the Department converted in 1996 to the commercial plan. The commercial plan includes veterans in the Department's self-funded mandatory plan which preceded the commercial insurance and veterans who obtained their Contracts of Purchase after implementation of the commercial insurance. The BSA concluded that the self-funded portion of the insurance program is currently underfunded. In addition, the BSA concluded that the short-term nature of commercial insurance policies, the high cost of a self-funded insurance program, the scarcity of available funding sources, and the unpredictability of future participation in the loan and insurance programs impose difficulties in forecasting the long-term costs of the insurance program. The BSA also concluded that the Department's administration of the insurance program contains flaws that weaken the Department's ability to manage the insurance program and safeguard assets.

The BSA urged the Department to develop a long-term strategy to address its insurance program. The BSA suggested that the Department, in deciding the future of the insurance program, consider the above-listed factors in forecasting costs of the program. The BSA further suggested that the Department could increase funding for the insurance program using a limited amount of loan program funds that would not adversely affect the Department's ability to meet bond payments, through modest increases in premiums, and through savings in the operational costs for the loan program. In addition, the BSA suggested that the Department consider discontinuing the insurance program for certain veterans who are not currently disabled. Finally, the BSA suggested that the Department follow State guidelines to improve the administration of the insurance program.

In a written response to a draft of the audit report, the Department stated that sufficient funds to pay liabilities under the self-funded plan are made available as needed and that the current cash reserves are more than adequate for such purposes for the immediate future. The Department agreed with the BSA's suggestion of factors it should consider when deciding the future of the insurance program, but noted that its primary responsibility is to ensure the health of the Program overall. Finally, the Department asserted that it has already taken steps to conform its administration of the insurance program to State guidelines. See "THE PROGRAM - Property and Life and Disability Insurance" and APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Copies of the 1998/99 LAO Reports and the May 25, 2000 and March 28, 2001 reports of the BSA, including the Department's responses thereto, are available from the Department upon request.

The financial performance of and loan origination activities of the Department are discussed elsewhere in this Official Statement. The Department does not believe that either termination of loan originations or use of Department moneys to fund other programs, if either or both of such actions were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds. While the Legislature could enact any or all of the recommendations in the 1998/99 LAO Reports or any recommendations of the BSA, use of moneys in the 1943 Fund for veterans benefits outside of the Program may be subject to approval by the electorate of the State and may also be subject to other legal restrictions. For financial information concerning the 1943 Fund, see "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION," APPENDIX A – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2000 AND 1999 AND INDEPENDENT AUDITOR'S REPORT" and APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS

General

The Revenue Bonds are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the 1943 Fund other than proceeds of Veterans G.O. Bonds and any amounts in any Rebate Account, (ii) the Bond Reserve Account, and (iii) the Loan Loss Account. **State law provides that such undivided interest in the assets of the 1943 Fund is secondary and subordinate to the obligation of the 1943 Fund to pay or reimburse debt service on the Veterans G.O. Bonds, as described below. The Department has no taxing power. Neither the faith and credit nor the taxing power of the State of California or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Revenue Bonds.**

The Offered Revenue Bonds will be the subject of the Financial Guaranty Insurance Policy, as described below. The Resolution does not require that Revenue Bonds be the subject of a bond insurance policy or other form of credit enhancement. See "THE FINANCIAL GUARANTY INSURANCE POLICY."

The 1943 Fund

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds from the sale of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds and of the State for reimbursement of debt service payments made on Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described in "THE PROGRAM - Property and Life and Disability Insurance."

For financial information concerning the 1943 Fund, see "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION" and also see APPENDIX A - "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2001 AND 2000 AND INDEPENDENT AUDITOR'S REPORT."

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid to the General Fund from the 1943 Fund must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of August 1, 2001, there were outstanding \$2,415,765,000 aggregate principal amount of Veterans G.O. Bonds, not including the Winter 2001 Veterans G.O. Bonds. Currently, \$605,585,000 of new issue Veterans G.O. Bonds are authorized but not issued. The Winter 2001 Veterans G.O. Bonds will not use any of such \$605,585,000 authorization. As of August 1, 2001, there were outstanding \$570,940,000 aggregate principal amount of Revenue Bonds, not including the Offered Revenue Bonds. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Veterans G.O. Bonds and Revenue Bonds."

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM - Contracts of Purchase" and APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase."

Bond Reserve Account

Resolution RB-1 requires the establishment and, from available Revenues, maintenance of a Bond Reserve Account in an amount at least equal to the Bond Reserve Requirement. Resolution RB-1 creates a lien in favor of the holders of the Revenue Bonds on amounts in the Bond Reserve Account which are not in excess of the Bond Reserve Requirement (as defined below). Resolution RB-1 establishes the Bond Reserve Requirement as of any date of calculation to be an amount equal to the aggregate of the amounts established by each Series Resolution authorizing Revenue Bonds, at least equal in the aggregate to 3% of the aggregate Outstanding principal amount of the Revenue Bonds with interest rates fixed to maturity (the "Bond Reserve Requirement"). For purposes of calculating the Bond Reserve Requirement, the Resolution established (1) with respect to the Prior Revenue Bonds, an amount equal to 7% of the Outstanding principal amount of the Prior Revenue Bonds, and (2) with respect to the Offered Revenue Bonds, an amount equal to 5% of the Outstanding principal amount of the Offered Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and interest on the Revenue Bonds or making Mandatory Sinking Account Payments (but only in the event that no other moneys other than certain moneys in the Revenue Bond Series Bond Proceeds Subaccounts or Revenue Bond Series Proceeds Recycling Subaccounts are available therefor). Resolution RB-1 directs that amounts on deposit in the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement be transferred at the request of the Department to the Loan Loss Account, the Revenue Account or the Proceeds Account.

As of September 30, 2001, the Bond Reserve Requirement was \$39,965,000 and the amount on deposit in the Bond Reserve Account was at least equal to the Bond Reserve Requirement.

Although the Department used cash to fund the Bond Reserve Requirement with respect to the Prior Revenue Bonds (and expects to use cash to fund the Bond Reserve Requirement with respect to the Offered Revenue Bonds), the Series Resolutions authorizing the issuance of the Prior Revenue Bonds (including the Offered Revenue Bonds) provide that Cash Equivalents may replace such cash in the future. Resolution RB-1 permits Series Resolutions authorizing Additional Revenue Bonds to provide that Cash Equivalents be used to fund the Bond Reserve Requirement with respect to the Series of Bonds so authorized.

APPENDIX B includes audited financial statements of the Bond Reserve Account.

Loan Loss Account

There are currently no amounts on deposit or required to be on deposit in the Loan Loss Account. No deposits will be required in connection with the issuance of the Offered Revenue Bonds.

Resolution RB-1 requires that the amount on deposit in the Loan Loss Account must be at least equal to the Loan Loss Requirement before any Additional Revenue Bonds may be issued. Resolution RB-1 establishes the Loan Loss Requirement, as of any date of calculation, as an amount equal to the amount established in the then-current Cash Flow Statement, as described below under "Cash Flow Statements and Program Operating Procedures." The Cash Flow Statement which will be in effect upon the issuance of the Offered Revenue Bonds will not establish a Loan Loss Requirement. Resolution RB-1 provides that, pursuant to the Program

Operating Procedures, moneys held for the credit of the Loan Loss Account as of any date at the request of the Department will be transferred to the Revenue Account, the Bond Reserve Account, the Proceeds Account or any Revenue Subaccount established with respect to the Veterans G.O. Bonds. Amounts in the Loan Loss Account will be used to pay the principal of and interest on the Revenue Bonds or to make Mandatory Sinking Account Payments.

Resolution RB-1 permits Series Resolutions authorizing Additional Revenue Bonds to provide that Cash Equivalents be used to fund the Loan Loss Requirement with respect to the Series of Bonds so authorized.

Cash Flow Statements and Program Operating Procedures

Resolution RB-1 requires that the Department file a Cash Flow Statement with the Trustee (i) upon adoption of a Series Resolution authorizing Additional Revenue Bonds or amending Resolution RB-1 or any Series Resolutions or Supplemental Resolution, (ii) upon the issuance of any series of Veterans G.O. Bonds, (iii) when required pursuant to any Series Resolution or Supplemental Resolution, (iv) upon any change in the Program Operating Procedures described below and (v) in connection with complying with the requirements described below under "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS – Maintenance of Fund Parity." Resolution RB-1 permits the Department to file a new Cash Flow Statement at any time. Resolution RB-1 requires that any Cash Flow Statement be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

Resolution RB-1 requires that a Cash Flow Statement consist of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Revenue Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto. Under Resolution RB-1, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect of the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the Revenue Account under Resolution RB-1, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account or the Loan Loss Account, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any Series Resolution.

Resolution RB-1 requires that a Cash Flow Statement will (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account, and the Loan Loss Account as of the stated starting date of the projection, (ii) reflect all the significant transactions that have occurred in the period commencing with such starting date and ending with a date no more than ninety (90) days prior to the date of such projections, (iii) be consistent with Resolution RB-1, and (iv) assume compliance with the then-current Program Operating Procedures. For each scenario included therein, Resolution RB-1 requires that the Cash Flow Statement set forth the assumptions on which it is based including, without limitation, the following:

(i) the timing and terms of issuance or remarketing of Revenue Bonds and Veterans G.O. Bonds;

(ii) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;

(iii) the timing and amounts of the receipt of payments of scheduled principal of and interest on Contracts of Purchase;

(iv) the timing and amounts of prepayments on Contracts of Purchase;

(v) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;

(vi) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will be subject to an investment agreement;

(vii) the performance by the Department's counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds;

(viii) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and

(ix) the Loan Loss Requirement.

According to Resolution RB-1, the Department will not be in default under Resolution RB-1 merely because a Cash Flow Statement shows that projected Revenues will be insufficient to provide for timely payments of interest on and principal of the Revenue Bonds and Expenses, but is required to take all reasonable actions to eliminate such deficiency.

The Program Operating Procedures are operating policies of the Department governing discretionary activities under Resolution RB-1. Resolution RB-1 requires the Department to administer the Program and perform its obligations under Resolution RB-1 in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures may be amended if (1) a Cash Flow Statement is delivered to the Trustee, and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on the Revenue Bonds from the gross income of the holders thereof for Federal income tax purposes.

Cash Flow Statements to be Delivered in Connection with the Offered Revenue Bonds

As a condition to the issuance of the Offered Revenue Bonds, the Department will provide the Trustee with its Cash Flow Statement in the form required by Resolution RB-1. The Cash Flow Statement will consist of the conclusion by an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal

on the Revenue Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto (the "Issuance Cash Flow Projections"). The Issuance Cash Flow Projections will be prepared by cfX Incorporated ("cfX"), pursuant to its engagement as Quantitative Consultant to the Department. The Issuance Cash Flow Projections and the conclusions of cfX contained in its accompanying cash flow letter will be based solely on information provided to cfX by the Department and the Trustee and certain assumptions provided to cfX by the Department and upon scenarios generally specified by the Rating Agencies to be tested; cfX makes no representation with respect to the accuracy of such information or as to the reasonableness of such assumptions and scenarios.

The Issuance Cash Flow Projections will be based on the financial condition of the 1943 Fund as of June 30, 2001 (as presented in the audited financial statements of the 1943 Fund as of June 30, 2001) and will reflect significant financial transactions within the 1943 Fund through September 30, 2001, as explained to cfX by the Department. The Issuance Cash Flow Projections will reflect (i) the assumed delivery of the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds as part of the overall financing plan (but no additional future issuance of either Revenue Bonds or Veterans G.O. Bonds), and (ii) the initial application of proceeds of such bonds in accordance with the Department's expected terms of the applicable Series Resolution and resolutions of issuance.

The Issuance Cash Flow Projections will include each of the scenarios generally specified and included in the final presentations to the Rating Agencies in connection with the Department's application for an appropriate rating on the Offered Revenue Bonds. Such scenarios reflect a combination of assumptions required by the Rating Agencies to be used with respect to future market conditions and behavior of eligible and participating veterans under such market conditions. cfX makes no representation with respect to the sufficiency of Revenues to provide for timely payments of interest and principal on the Revenue Bonds and Expenses under any scenario not presented in the Issuance Cash Flow Projections. Among other assumptions, the Issuance Cash Flow Projections will include alternative scenarios under which:

(i) No future prepayments are received with respect to Contracts of Purchase, or, alternatively, that prepayments are received at a number of specified annualized constant prepayment rates.

(ii) As of specified dates, no additional Contracts of Purchase are funded and unexpended amounts are applied to the redemption of Revenue Bonds and Veterans G.O. Bonds.

(iii) A specified level of unreimbursed losses is incurred with respect to defaulted Contracts of Purchase.

Each scenario in the Issuance Cash Flow Projections will reflect future transactions expected to be executed by the Department and the Trustee (among others) with respect to: (i) the application for Program purposes of amounts in the Proceeds Account established under Resolution RB-1, (ii) the collection and deposit of Revenues, (iii) the investment of amounts on deposit in various Accounts in both specified and unspecified investments, (iv) the transfer of funds between Accounts, (v) the payment of Expenses, and (vi) the redemption of Revenue Bonds and Veterans G.O. Bonds. All of the scenarios included in Issuance Cash Flow Projections assume that the Department and the Trustee execute such transactions on a timely basis in conformance with the requirements of Resolution RB-1, the Series Resolution authorizing the

issuance of the Offered Revenue Bonds and future Series of Revenue Bonds, the Program Operating Procedures, and the providers of third party investment contracts. cfX can provide no assurance that such actions will be timely taken.

Each scenario in the Issuance Cash Flow Projections will reflect future performance by third parties under investment and insurance contracts and will assume no default in performance. Each scenario will also assume that, with the exception of reserves and liabilities reflected on the 1943 Fund audited financial statements as of June 30, 2001, future operations of the life and disability insurance and property insurance programs offered by the Department will neither contribute to, nor require support from, the 1943 Fund.

The Cash Flow Statement and the Issuance Cash Flow Projections have not been and will not be verified for mathematical accuracy by an independent auditor.

Maintenance of Fund Parity

Resolution RB-1 requires that the Department cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals 25% (or such other percentage which may be set forth in the future in the Program Operating Procedures *provided* that any percentage which is less than 25% shall be the subject of a Rating Confirmation) (the "Applicable Fund Parity Percentage") of the then outstanding principal amount of Revenue Bonds, all Revenues in excess of Accrued Debt Service on the Revenue Bonds and Veterans G.O. Bonds shall thereafter be applied to redeem Revenue Bonds of the Series and in the manner reflected in a current Cash Flow Statement, until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such Applicable Fund Parity Percentage; *provided, further, however*, that no such Cash Flow Statement and no such redemption shall be required if the Department shall have provided a Rating Confirmation to the Trustee. The Department Certificate filed as of June 30, 2001 reflected Fund Parity in excess of the Applicable Fund Parity Percentage, which was 25% as of June 30, 2001.

Under Resolution RB-1, "Fund Parity" means, on any determination date, (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established under Resolution RB-1 and any Series Resolution or Supplemental Resolution, and (ii) the principal amount of all Revenue Bonds Outstanding and all Veterans G.O. Bonds outstanding (plus accrued interest), reduced by (b) allowances and reserves for loss coverage on Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures. Resolution RB-1 provides that "Accrued Debt Service" means, as of any date of determination and, as the context of Resolution RB-1 requires, with respect to all Revenue Bonds and Veterans G.O. Bonds, the sum of:

(b) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) below) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(c) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(d) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans G.O. Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

Under Resolution RB-1, "Monthly Debt Service Requirement" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

Additional Revenue Bonds

Resolution RB-1 permits the issuance of Series of Additional Revenue Bonds to carry out the provisions of the Act and other statutes enacted in support of the Program or to refund all or part of the Revenue Bonds or Veterans G.O. Bonds then Outstanding. Any Series of Additional Revenue Bonds issued under Resolution RB-1 (except for bonds which are subordinate obligations) will be on a parity with the then Outstanding Revenue Bonds, and will be entitled to the equal benefit, protection and security of the provisions, covenants and agreements of Resolution RB-1. Additional Revenue Bonds may have interest payment dates which differ from those of the Offered Revenue Bonds. Upon the issuance of any such Series of Additional Revenue Bonds, Resolution RB-1 requires the deposit into the Bond Reserve Account and the Loan Loss Account such amounts as are necessary to increase the amounts therein to, respectively, the Bond Reserve Requirement or the Loan Loss Requirement. Such deposit may be made from the 1943 Fund, the proceeds of sale of the Series of Additional Revenue Bonds or any other lawful source, or through the use of Cash Equivalents as provided in the Series Resolution authorizing the issuance of the Series of Additional Revenue Bonds. Under Resolution RB-1, issuance of Additional Revenue Bonds is conditioned upon delivery of a Cash Flow Statement and Rating Confirmation and upon certification that no Event of Default under Resolution RB-1 shall have occurred and be continuing.

Additional Veterans G.O. Bonds authorized by the voters of the State may be issued by the State from time to time to provide funds for the Program or to refund outstanding Veterans G.O. Bonds, subject to the delivery of a Cash Flow Statement. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS - THE 1943 FUND" for a discussion of authorized but unissued bonds.

THE FINANCIAL GUARANTY INSURANCE POLICY

General

The Offered Revenue Bonds will be the subject of a Financial Guaranty Insurance Policy described under this heading to be issued by the Insurer. The Financial Guaranty Insurance Policy is not a source of payment for any Revenue Bonds other than the Offered Revenue Bonds.

The summary of the terms of the Financial Guaranty Insurance Policy set forth below under the subcaption "The Insurer and the Financial Guaranty Insurance Policy" does not purport to be complete and is qualified in its entirety by reference to the Financial Guaranty Insurance Policy, the form of which appears in APPENDIX H hereto. All capitalized terms used under such subcaption and not otherwise defined in this Official Statement are used as defined in the Financial Guaranty Insurance Policy.

The information relating to the Insurer contained below under the subcaption "The Insurer and the Financial Guaranty Insurance Policy" has been furnished by the Insurer and neither the Department, the Trustee, nor the Underwriters have undertaken any independent investigation of the Insurer, its operations, or its financial guaranty insurance. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof. Neither the Department, the Trustee nor the Underwriters make any representation as to the ability of the Insurer to make payments under the Financial Guaranty Insurance Policy. See APPENDIX H - "FORM OF FINANCIAL GUARANTY INSURANCE POLICY." A Statement of Insurance relating to the Financial Guaranty Insurance Policy will be printed on the Offered Revenue Bonds.

The Insurer and the Financial Guaranty Insurance Policy

The following information has been furnished by the Insurer for use in the Official Statement. Reference is made to APPENDIX H for a specimen of the Financial Guaranty Insurance Policy.

Payment Pursuant to Financial Guaranty Insurance Policy. The Insurer has made a commitment to issue the Financial Guaranty Insurance Policy relating to the Offered Revenue Bonds effective as of the date of issuance of the Offered Revenue Bonds. Under the terms of the Financial Guaranty Insurance Policy, the Insurer will pay to The Bank of New York, in New York, New York or any successor thereto (the "Insurance Trustee") that portion of the principal of and interest on the Offered Revenue Bonds which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor (as such terms are defined in the Financial Guaranty Insurance Policy). The Insurer will make such payments to the Insurance Trustee on the later of the day on which such principal and interest becomes Due for Payment or within one business day following the date on which the Insurer shall have received notice of Nonpayment from the Trustee. The insurance will extend for the term of the Offered Revenue Bonds and, once issued, cannot be canceled by the Insurer.

The Financial Guaranty Insurance Policy will insure payment only on stated maturity dates and on dates on which Mandatory Sinking Account Payments are required to be paid, in the case of principal, and on stated dates for payment, in the case of interest. If the Offered Revenue Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all Outstanding Offered Revenue Bonds, the Insurer will remain obligated to pay principal of and interest on Outstanding Offered Revenue Bonds on the originally scheduled interest and principal payment dates and dates on which Mandatory Sinking Account Payments are required to be paid. In the event of any acceleration of the principal of the Offered Revenue Bonds, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration.

In the event the Trustee has notice that any payment of principal of or interest on an Offered Revenue Bond which has become Due for Payment and which is made to a Bondowner by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from the Insurer to the extent of such recovery if sufficient funds are not otherwise available.

The Financial Guaranty Insurance Policy does **not** insure any risk other than Nonpayment, as defined in the Financial Guaranty Insurance Policy. Specifically, the Financial Guaranty Insurance Policy does **not** cover: (i) payment on acceleration, as a result of a call for redemption (other than mandatory redemption from Mandatory Sinking Account Payments) or as a result of any other advancement of maturity, (ii) payment of any redemption, prepayment or acceleration premium, and (iii) nonpayment of principal or interest caused by the insolvency or negligence of the Trustee, if any.

If it becomes necessary to call upon the Financial Guaranty Insurance Policy, payment of principal requires surrender of Offered Revenue Bonds to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Offered Revenue Bonds to be registered in the name of the Insurer to the extent of the payment under the Financial Guaranty Insurance Policy. Payment of interest pursuant to the Financial Guaranty Insurance Policy requires proof of Bondowner entitlement to interest payments and an appropriate assignment of the Bondowner's right to payment to the Insurer.

Upon payment of the insurance benefits, the Insurer will become the owner of the Offered Revenue Bond, appurtenant coupon, if any, or right to payment of principal or interest on such Offered Revenue Bond and will be fully subrogated to the surrendering Bondowner's rights to payment.

In the event that the Insurer were to become insolvent, any claims arising under the Financial Guaranty Insurance Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Ambac Assurance Corporation. The Insurer is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam, and the Commonwealth of Puerto Rico, with admitted assets of approximately \$4,988,000,000 (unaudited) and statutory capital of approximately \$2,963,000,000 (unaudited) as of September 30, 2001. Statutory capital consists of the Insurer's policyholders' surplus and statutory contingency reserve. Standard & Poors's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("S&P"), Moody's Investors Service ("Moody's") and Fitch Inc. ("Fitch") have each assigned a triple-A financial strength rating to the Insurer.

The Insurer has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by the Insurer will not affect the treatment for Federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by the Insurer under policy provisions substantially identical to those contained in its Financial Guaranty Insurance Policy shall be treated for Federal income tax purposes in the same manner as if such payments were made by the obligor of the Offered Revenue Bonds.

The Insurer makes no representation regarding the Offered Revenue Bonds or the advisability of investing the Offered Revenue Bonds and makes no representation regarding, nor has it participated in the presentation of, this Official Statement other than the information supplied by the Insurer in this section and in APPENDIX H.

Available Information. The parent company of the Insurer, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information may be inspected and copied at the public reference facilities maintained by the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the Commission's regional office at Northwestern Atrium Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. In addition, the aforementioned material may also be inspected at the offices of the New York Stock Exchange, Inc. (the "NYSE") at 20 Broad Street, New York, New York 10005. The Company's Common Stock is listed on the NYSE.

Copies of the Insurer's financial statements prepared in accordance with statutory accounting standards are available from the Insurer. The address of the Insurer's administrative offices and its telephone number are One State Street Plaza, 17th Floor, New York, New York 10004 and (212) 668-0340.

Incorporation of Certain Documents by Reference. The following documents filed by the Company with the Commission (File No. 1-10777) are incorporated by reference in this Official Statement.

(1) The Company's Annual Report on Form 8-K dated January 24, 2001 and filed on January 24, 2001;

(2) The Company's Current Report on Form 8-K dated March 19, 2001 and filed on March 19, 2001;

(3) The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 and filed on March 28, 2001;

(4) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 2001 and filed on May 15, 2001;

(5) The Company's Current Report on Form 8-K dated July 18, 2001 and filed on July 23, 2001;

(6) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 2001 and filed on August 10, 2001;

(7) The Company's Current Report on Form 8-K dated and filed on September 17, 2001;

(8) The Company's Current Report on Form 8-K dated and filed on September 19, 2001;

(9) The Company's Current Report on Form 8-K dated and filed on October 22, 2001; and

(10) The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended September 30, 2001 and filed on November 14, 2001.

All documents subsequently filed by the Company pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "Available Information."

SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION

Selected Financial Data of the 1943 Fund

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 2001 and 2000 have been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in APPENDIX A in this Official Statement, and the Department's accounting records. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1999, 1998 and 1997 have also been derived from the audited financial statements of the 1943 Fund which are not included herein. **This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said APPENDIX A and the Department's Discussion of Financial Data contained herein.**

Beginning with the fiscal year ended June 30, 1998, the financial statements of the 1943 Fund are required to reflect accounting changes required by promulgation of Statement No. 31 by the Governmental Accounting Standards Board ("GASB 31"). GASB 31 requires all investments to be reported at their fair market value (rather than book value) and investment income to be adjusted to reflect the difference between the fair market and book value of investments as either a capital gain or loss. The financial data derived from the financial statements of the 1943 Fund for FY 1997 and presented in the tables below have been adjusted to reflect the impact of GASB 31 on investments and investment income so as to make such data consistent with the accounting procedures used in preparing the Department's financial statements for FY 1998 and thereafter.

The impact of GASB 31 adjustments over the five-year period reflected in the tables below (including FY 2001) are a cumulative increase of \$2,225,000 in the deficiency of revenues over expenses and cumulative decrease of the same amount in retained earnings.

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SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	<u>June 30, 2001</u>	<u>June 30, 2000</u>	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF*	\$324,158	\$226,076	\$239,979	\$325,321	\$317,178
Guaranteed Investment Contracts	319,476	562,380	890,692	938,888	365,542
Treasury Securities	<u>0</u>	<u>112,107</u>	<u>183,645</u>	<u>187,851</u>	<u>47,214</u>
Total	643,634	900,563	1,314,316	1,452,060	1,029,934
DUE FROM VETERANS					
DEBENTURE REVENUE FUND	40,905	33,847	22,471	12,686	86,279
OTHER CURRENT ASSETS	30,333	30,903	18,335	13,755	22,596
NET OTHER NON-CURRENT ASSETS	33,329	33,255	33,262	36,406	15,123
CONTRACTS OF PURCHASE					
Performing Contracts	2,605,059	2,418,292	2,040,587	2,035,879	2,154,142
Non Performing Contracts	<u>18,182</u>	<u>16,764</u>	<u>28,669</u>	<u>62,872</u>	<u>75,038</u>
Total	2,623,241	2,435,056	2,069,256	2,098,751	2,229,180
Allowance For Contract Losses	(16,715)	(19,676)	(21,263)	(22,005)	(26,412)
Reduction of REO to Fair Value	<u>(2,592)</u>	<u>(3,050)</u>	<u>(8,104)</u>	<u>(19,003)</u>	<u>(24,003)</u>
Total	<u>(19,307)</u>	<u>(22,726)</u>	<u>(29,367)</u>	<u>(41,008)</u>	<u>(50,415)</u>
BONDS PAYABLE					
General Obligation Bonds	(2,415,765)	(2,528,330)	(2,687,390)	(2,947,165)	(2,632,045)
Revenue Bonds	<u>(570,940)</u>	<u>(505,815)</u>	<u>(404,215)</u>	<u>(275,055)</u>	<u>(327,580)</u>
Total	<u>(2,986,705)</u>	<u>(3,034,145)</u>	<u>(3,091,605)</u>	<u>(3,222,220)</u>	<u>(2,959,625)</u>
OTHER CURRENT LIABILITIES	<u>(60,081)</u>	<u>(87,598)</u>	<u>(56,369)</u>	<u>(58,458)</u>	<u>(80,502)</u>
Net Lending & Financing Activities Assets	<u>305,349</u>	<u>289,155</u>	<u>280,299</u>	<u>291,972</u>	<u>292,570</u>
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:					
LIFE AND DISABILITY COVERAGE					
Deposits with Insurance Administrators	16,289	23,010	30,573	40,823	48,762
Insurance Reserves	<u>(26,726)</u>	<u>(31,642)</u>	<u>(39,751)</u>	<u>(53,185)</u>	<u>(65,828)</u>
Total	(10,437)	(8,632)	(9,178)	(12,362)	(17,066)
RATE STABILIZATION RESERVE FOR LIFE AND DISABILITY PREMIUMS**	(5,700)	(5,700)			
FIRE AND HAZARD COVERAGE					
Deposits with Insurance Administrators	1,850	1,850	1,850	1,850	1,850
Accrued Liabilities	<u>(3,016)</u>	<u>(3,236)</u>	<u>(3,402)</u>	<u>(3,059)</u>	<u>(3,255)</u>
Total	<u>(1,166)</u>	<u>(1,386)</u>	<u>(1,552)</u>	<u>(1,209)</u>	<u>(1,405)</u>
Net Insurance Activities Liabilities	<u>(17,303)</u>	<u>(15,718)</u>	<u>(10,730)</u>	<u>(13,571)</u>	<u>(18,471)</u>
RETAINED EARNINGS	<u>\$288,046</u>	<u>\$ 273,437</u>	<u>\$ 269,569</u>	<u>\$ 278,401</u>	<u>\$ 274,099</u>
SUMMARY INFORMATION					
Total Assets	\$3,344,000	\$3,411,000	\$3,435,000	\$3,587,000	\$3,377,000
Total Liabilities	3,056,000	\$3,137,000	\$3,166,000	\$3,309,000	\$3,103,000
Total Number of Contracts of Purchase	32,473	33,440	32,243	35,906	39,343

*Surplus Money Investment Fund

**Reclassification for Liabilities

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	<u>June 30, 2001</u>	<u>June 30, 2000</u>	<u>June 30, 1999</u>	<u>June 30, 1998</u>	Restated <u>June 30, 1997</u>
NET INCOME FROM LENDING AND FINANCING ACTIVITIES:					
INTEREST INCOME					
Interest on Contracts	\$179,755	\$150,213	\$139,839	\$162,086	\$175,186
Interest on Investments	40,194	69,471	75,292	74,077	67,373
Transfers of Interest From Veterans Debenture Revenue Fund	<u>2,219</u>	<u>1,476</u>	<u>887</u>	<u>3,317</u>	<u>10,843</u>
Total	<u>222,168</u>	<u>221,160</u>	<u>216,018</u>	<u>239,480</u>	<u>253,402</u>
BOND INTEREST EXPENSE	<u>(188,017)</u>	<u>(193,495)</u>	<u>(201,772)</u>	<u>(218,757)</u>	<u>(230,871)</u>
Net Interest Income	<u><u>34,151</u></u>	<u><u>27,665</u></u>	<u><u>14,246</u></u>	<u><u>20,723</u></u>	<u><u>22,531</u></u>
RESERVE FOR RATE STABILIZATION					
GASB 31 ADJUSTMENT	351	479	(6,897)	(4,578)	8,420
GAIN ON SALE OF SECURITIES	1,130	270	2,351	13,460	
RESTRUCTURING EXPENSES	<u>(3,642)</u>	<u>(2,629)</u>	<u>(6,342)</u>	<u>(3,068)</u>	
	<u>(2,161)</u>	<u>(7,580)</u>	<u>(10,888)</u>	<u>5,814</u>	<u>8,420</u>
CONTRACTS OF PURCHASE					
PMI	(7,658)	(86)	(2,330)	(1,551)	
Net gain (loss) on Sale of REO'S	55	(2,683)	(3,886)	(3,128)	(8,309)
(Increase) Decrease in Allowance for Contract Losses	<u>3,420</u>	<u>6,641</u>	<u>3,343</u>	<u>(1,312)</u>	<u>(22,677)</u>
Total	<u>(4,183)</u>	<u>3,872</u>	<u>(2,873)</u>	<u>(5,991)</u>	<u>(30,986)</u>
Net Lending/Financing Activities Income (Expense)	<u><u>27,807</u></u>	<u><u>23,957</u></u>	<u><u>485</u></u>	<u><u>20,546</u></u>	<u><u>(35)</u></u>
NET INCOME FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenues	8,128	5,779	3,826	1,891	2,290
Operating Expenses	<u>(21,541)</u>	<u>(23,902)</u>	<u>(19,543)</u>	<u>(20,381)</u>	<u>(20,218)</u>
Net Administrative Activities Expense	<u><u>(13,413)</u></u>	<u><u>(18,123)</u></u>	<u><u>(15,717)</u></u>	<u><u>(18,490)</u></u>	<u><u>(17,928)</u></u>
NET INCOME FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	(2,571)	(3,374)	5,290	160	3,570
Fire and Hazard Coverage	<u>2,786</u>	<u>1,408</u>	<u>1,110</u>	<u>2,086</u>	<u>326</u>
Net Insurance Activities Income (Expense)	<u><u>215</u></u>	<u><u>(1,966)</u></u>	<u><u>6,400</u></u>	<u><u>2,246</u></u>	<u><u>3,896</u></u>
TOTAL EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER EXPENSES	<u><u>14,609</u></u>	<u><u>3,868</u></u>	<u><u>(8,832)</u></u>	<u><u>4,302</u></u>	<u><u>(14,067)</u></u>
RETAINED EARNINGS	<u><u>\$288,046</u></u>	<u><u>\$ 273,437</u></u>	<u><u>\$ 269,569</u></u>	<u><u>\$ 278,401</u></u>	<u><u>\$ 274,099</u></u>

Department's Discussion of Financial Data

Certain aspects of the Department's financial results as presented in the five-year tables are discussed below. While the financial results for FY 2001 are the most positive during the five-year period, the continued implementation of the Department's programmatic and financial management revisions may result in losses in future years.

Overview. Although the Program has experienced losses during two of the last five years, the impact of significant programmatic and financial management changes implemented substantially during FY 1998 is evidenced in the FY 2001 financial results. Since FY 1996, the Department has (a) expanded eligibility requirements for borrowers and created competitive Program terms to stimulate growth of its portfolio of Contracts of Purchase, (b) established a flexible interest rate setting mechanism on new Contracts of Purchase, (c) secured primary mortgage insurance for over \$700,000,000 of outstanding Contracts of Purchase previously self-insured by the 1943 Fund, (d) implemented requirements for guarantees by the United States Department of Veterans Affairs or other primary mortgage insurance on most newly originated high loan-to-value ("LTV") Contracts of Purchase, (e) converted a majority of its life and disability coverage plan from a self-insured program to third-party insurance, (f) revised Contract of Purchase underwriting and servicing procedures to improve the performance of the Contracts of Purchase portfolio, including aggressive disposition of its inventory of repossessed properties ("REOs") to reduce carrying costs and exposure on previously defaulted Contracts of Purchase, and (g) implemented a new Integrated Loan Processing and Financial Information Management System for origination and servicing of new Contracts of Purchase.

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of \$288,046,000 as of June 30, 2001 which represents an increase of 5.3% over the prior year. The overall asset-to-liability ratio for the 1943 Fund increased to 109% up from an average of 108% over the prior four fiscal years. The excess of revenues over expenses for the Program for FY 2001 was \$14,609,000 and represents a \$10,741,000 increase over the FY 2000 gain of \$3,868,000, largely as a result of: (a) continued improvement in net interest income and (b) the one-time charge for the life and disability coverage rate stabilization reserve, which was reflected in the prior year.

Assets and Liabilities. From FY 2000 to FY 2001, the outstanding balance of Contracts of Purchase (as measured at fiscal year end) increased by 7.7% from \$2,435,056,000 to \$2,623,241,000. The amount of Contracts of Purchase funded during FY 2001 was \$469,119,000, consisting of funding from the following sources of approximately: (a) \$139,500,000 of bond proceeds, (b) \$151,000,000 of recycled Contracts of Purchase principal receipts (including prepayments) and (c) \$178,619,000 of other invested funds. New originations during FY 2001 were offset by prepayments of Contracts of Purchase of \$189,902,000 and scheduled repayments of principal of \$91,033,000.

The ability of the Department to sustain the increase in the outstanding balance of Contracts of Purchase in future periods will depend upon a variety of factors including, among others: (a) the level of mortgage interest rates offered in the private market relative to the interest rates established from time-to-time by the Department for newly originated Contracts of Purchase, the general level of home purchase and construction activity in the State, and the demographics of the eligible veterans population, which will each directly impact the rate of origination of Contracts of Purchase, (b) the level of mortgage interest rates offered in the private market

relative to the interest rates on outstanding Contracts of Purchase, which will directly impact the rate of prepayment of Contracts of Purchase, and (c) the seasoning of the outstanding Contracts of Purchase, which will directly impact the rate of scheduled principal receipts. The Department has experienced significant variation in the change in the outstanding balance of Contracts of Purchase in prior fiscal years. See also APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds."

The Department's Contracts of Purchase interest-rate setting mechanism permits it to periodically adjust the interest rates on newly originated Contracts of Purchase. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after September 1, 2001 are currently 6.00% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 6.25% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds, and 6.50% for Contracts of Purchase using Unrestricted Moneys

During FY 2001, cash and investments declined by \$256,929,000. Most of this reduction is due to the application of such funds to finance new Contracts of Purchase. The balance of this reduction is the result of such funds being applied to debt retirement.

Beginning in FY 1996, the Department moved aggressively to repossess properties of canceled Contracts of Purchase and dispose of its REOs which had increased significantly in the early 1990s due to the decline in real estate values and overall economic conditions in certain California housing sub-markets. The principal balance of Contracts of Purchase classified as REOs increased by \$1,418,000 from June 30, 2000 to June 30, 2001. However, the aggregate reduction in Contracts of Purchase classified as REOs from June 30, 1997 to June 30, 2001 is \$56,856,000. Due to the increased size of the portfolio, as well as continued aggressive REO management and disposition efforts, the amount of non-performing Contracts of Purchase at June 30, 2001 remained at approximately 0.7% of the Department's portfolio.

In conjunction with this effort, the Department periodically reassesses the adequacy of its loss reserves. During FY 2001, the Department's loss allowance was reduced by \$3,420,000 due to the adequacy of reserves funded in prior years, improvement in the overall performance of the Contract portfolio and insurance coverage. Accumulated loss reserves decreased \$31,108,000 or 61.7% over the last four years. The remaining loss reserve of \$19,307,000 at June 30, 2001, together with the Department's (a) purchase of primary mortgage insurance during FY 1998 with respect to certain outstanding Contracts of Purchase with high LTVs, (b) imposition of USDVA guarantees for certain high LTV Contracts of Purchase originated beginning in April 1998, and (c) imposition of additional primary mortgage insurance provided by Radian Guaranty Inc. ("Radian") for certain newly originated high LTV Contracts of Purchase which are not eligible for USDVA guarantees are intended to provide for future potential REO losses. (See "THE PROGRAM - Loan Insurance.")

In FY 2001 the Department continued to reduce its exposure to market volatility with the final liquidation of the portfolio of Treasury securities previously held directly in the 1943 Fund and the increased use of investment contracts for various accounts. See APPENDIX D - "CERTAIN DEPARTMENTAL FINANCIAL INFORMATION AND OPERATING DATA."

The Department continued the addition of long-term Revenue Bonds into its overall debt structure with such bonds making up 19.1% of all outstanding Veterans G.O. Bonds and Revenue

Bonds at June 30, 2001 – the highest level since 1995. The growth rate of additional Revenue Bonds should decrease as a result of the substantial completion of the Department's pre-Ullman (defined herein) refunding efforts, which provide Unrestricted Moneys to finance Contracts of Purchase for certain veterans. In addition, during FY 2001, the Department continued to reduce the impact of non-callable Veterans G.O. Bonds issued in the early 1980s. By June 30, 2001, approximately \$658,790,000 of such bonds remained outstanding, with a remaining average life of only 4.6 years and an average interest cost of approximately 9%. As of June 30, 2001, the non-callable bonds represent 22% of the total Veterans G.O. Bonds and Revenue Bonds outstanding.

Beginning June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured interim plan underwritten by an outside commercial insurer except for that portion of the life and disability insurance program covering existing claims of disabled Contract of Purchase holders for whom the Department continues to provide coverage. Effective February 1, 1998, the interim plan was replaced, after a competitive bidding process, by a replacement, long-term life insurance and disability plan provided by the same commercial insurer. During FY 2000, the Department established a reserve in the amount of \$5,700,000 to provide a source for stabilizing premiums to Veterans under the life and disability insurance program. To date, no portion of such reserve has been utilized.

For those Contract of Purchase holders for whom the Department continues to provide self-insured coverage, loss reserves for such obligations have been actuarially based and have been decreased in FY 2001 based on the characteristics of the Department's Contracts of Purchase portfolio and the amount of funded reserves. Approximately 61% of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability.

Income and Expenses. The Program's FY 2001 net interest income (total interest income less bond interest expense) of \$34,151,000 was \$6,486,000 greater than FY 2000. However, the FY 2000 net interest income amount includes a non-recurring item of approximately \$7,300,000 for recognition of investment earnings which were received on refunding escrows established in prior years. Comparing FY 2001 net interest income to an adjusted FY 2000 net interest income amount of \$20,365,000 to exclude this non-recurring item, results in an increase in both net interest income of \$13,786,000 and net interest margin (net interest income divided by average interest bearing assets) of 1.02%. This increase in net interest margin from 0.60% in FY 2000 reflects (a) the continued conversion of lower yielding investments to higher yielding Contracts of Purchase, (b) the reduced interest expense as high coupon non-callable bonds matured, and (c) the reduced interest expenses as high coupon callable bonds were refunded. As a result of the shift of assets from investments to Contracts of Purchase, FY 2001 interest income from Contracts of Purchase increased by \$29,542,000 while interest income from investments fell by only \$21,977,000 (as adjusted for the recognition of escrow earnings as described above), even though the average interest bearing assets fell by 1.5%. As a result of maturing non-callable debt, interest expense on such bonds in excess of interest income on related Contracts of Purchase fell by approximately \$1,400,000 when compared to the prior year. Interest expense on the remainder of the outstanding bonds was favorably affected by the refunding of \$295,330,000 of callable bonds during FY 2000 and FY 2001.

The ability of the Department to sustain the increase in net interest income in future periods will depend upon a variety of factors including, among others: (a) the level of interest rates available on short term investments (including the rate paid on SMIF and on newly acquired

investment contracts) relative to the level of interest rates on outstanding bonds, (b) the rate of origination and the rate of prepayment of Contracts of Purchase, which will directly impact the amount of bond proceeds, recycling funds, and revenues held in such investments, (c) the interest rates established from time to time by the Department for newly originated Contracts of Purchase relative to the interest cost on bonds issued to finance such Contracts of Purchase, and (d) the interest rates on outstanding Contracts of Purchase relative to the interest cost on outstanding bonds, which will directly depend on the Department's ability to use special and optional redemption provisions to minimize the overall cost of outstanding debt. The Department has experienced significant variation in net interest income over the prior fiscal years.

In addition, income was positively affected in FY 2001 by a \$1,130,000 increase in the effect of realized and unrealized gains on securities due to changes in market value and a \$351,000 increase to reflect GASB 31 accounting requirements. During FY 2001 income was negatively affected by continued amortization of \$3,642,000 of the financing and redemption costs relating to the issuance of and refunding of bonds, which are expected to represent recurring expenses for future years' operations.

In FY 2001, the Department realized a small gain in its real estate risk activities, and a small gain in its insurance activities from the existing life and disability coverage plan and fire and hazard coverage plan.

Program administrative operating expenses in FY 2001 were \$21,541,000, a decrease of 9.9% from FY 2000. This reduction is due in part to completion of the implementation of the Department's Integrated Loan Processing and Information Management System. A substantial portion of the increase in operating revenues for FY 2001 is attributable to loan guaranty fees which are also taken into account in the number reflected under "Contracts of Purchase – PMI."

The Financial Statements of the 1943 Fund for Fiscal Years 2001 and 2000 and the Independent Auditors' Report can be found in APPENDIX A. "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA" can be found in APPENDIX D.

THE OFFERED REVENUE BONDS

General

The Offered Revenue Bonds will be dated, will bear interest at the rates, will be payable on the dates and will mature in the amounts and on the dates set forth on the cover page of this Official Statement. Interest on the Offered Revenue Bonds is calculated on the basis of a 360-day year consisting of twelve 30-day months.

The Offered Revenue Bonds are in fully-registered form only and when delivered will be registered in the name of Cede & Co. as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Offered Revenue Bonds. The Offered Revenue Bonds are in book-entry form only in denominations of \$5,000 and any integral multiple thereof. See "BOOK-ENTRY ONLY SYSTEM."

Redemption from Mandatory Sinking Account Payments

The Offered Revenue Bonds maturing on December 1, 2021 (the "2021 Term Bonds") and the Offered Revenue Bonds maturing on December 1, 2027 (the "2027 Term Bonds", together with the 2021 Term Bonds, the "Term Bonds") are subject to mandatory redemption prior to their respective stated maturities, in part, by lot, at a redemption price equal to 100% of the principal amount thereof plus accrued interest to the date fixed for redemption, without premium, from Mandatory Sinking Account Payments, on the respective dates and in the respective amounts as follows:

<u>Date</u> <u>(December 1)</u>	<u>2021 Term Bonds</u>	<u>2027 Term Bonds</u>
2018	\$ 9,225,000	
2019	9,710,000	
2020	10,210,000	
2021	10,735,000†	
2022		\$11,300,000
2023		11,885,000
2024		12,515,000
2025		13,170,000
2026		13,860,000
2027		14,590,000†

† Stated maturity.

Pursuant to the Resolution, if less than all of the Term Bonds of a maturity of the Offered Revenue Bonds are purchased or called for redemption (other than in satisfaction of Mandatory Sinking Account Payments), the Trustee will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity dates, as shown above) as directed by the Department or, if no direction is given, then against all applicable remaining Mandatory Sinking Account Payments in the proportion that the then-remaining balance of each such Mandatory Sinking Account Payment (including the principal amount due on the respective maturity date, as shown above) bears to the total of all applicable Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity dates, as shown above).

Optional Redemption

The Offered Revenue Bonds are subject to redemption at any time on or after June 1, 2012, at the option of the Department, and from any source of available funds, as a whole or in part by such maturity or maturities, and such amounts within each such maturity, as may be selected by the Department in its sole discretion (and by lot within a maturity), at redemption prices (expressed as percentages of the principal amount of the Offered Revenue Bonds or portion thereof to be redeemed) plus accrued interest to the date fixed for redemption, as follows:

<u>Redemption Period</u> <u>(both dates inclusive)</u>	<u>Redemption Price</u> <u>(as percentage of principal amount redeemed)</u>
June 1, 2012 to May 31, 2013	101 %
June 1, 2013 and thereafter	100

Special Redemption from Unexpended Proceeds and Excess Revenues

The Offered Revenue Bonds are subject to redemption at the option of the Department in whole or in part at any time, at a redemption price equal to 100% of the principal amount thereof plus interest accrued thereon to the date fixed for redemption in an amount equal to (i) moneys deposited in the 2002 A Revenue Bond Series Proceeds Subaccount that have not been applied to finance Contracts of Purchase, and (ii) Excess Revenues. The Offered Revenue Bonds to be so redeemed shall be such maturities, and such amounts within a maturity, as shall be selected by the Department. See "ESTIMATED APPLICATION OF OFFERED REVENUE BOND PROCEEDS" and APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for a discussion of the amount of moneys expected to be deposited in the 2002 A Revenue Bond Series Proceeds Subaccount upon the issuance of the Offered Revenue Bonds.

Factors which may affect the demand for Contracts of Purchase and consequently the Department's ability to use all of the proceeds of the Offered Revenue Bonds and Excess Revenues for the financing of Contracts of Purchase include not only general economic conditions, but also (among other factors) the relationship between alternative mortgage loan interest rates (including rates on mortgage loans insured or guaranteed by agencies of the federal government, rates on conventional mortgage loans and the rates on other Contracts of Purchase available from the Department), the interest rates being charged on the Contracts of Purchase by the Department, the general level of home purchase and construction activity in the State, and the demographics of the eligible veterans population. These factors could cause a lack of demand for Contracts of Purchase financed by the Offered Revenue Bonds and could necessitate the exercise by the Department of its right to apply the unused proceeds and Excess Revenues to redeem the Offered Revenue Bonds. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of moneys expected to become available to finance Contracts of Purchase upon the issuance of the Offered Revenue Bonds, " - Contracts of Purchase Origination and Prepayment Experience - New Contracts of Purchase During the Fiscal Year" for information regarding the recent rate of originations of Contracts of Purchase, and "- Selected Principal Flows with respect to Contracts of Purchase

Funded by both Veterans G.O. Bonds and Revenue Bonds" for the interest rates on new Contracts of Purchase originated since January 1, 1999.

Moneys are currently available through the issuance of Veterans G.O. Bonds and Revenue Bonds to finance Contracts of Purchase, and additional moneys are available and may become available to finance Contracts of Purchase through the concurrent and future issuances of Revenue Bonds and Veterans G.O. Bonds. Since the Department has full discretion, subject to eligibility requirements, and the requirements of the Federal Tax Code in applying the proceeds of all of these bonds to finance the Program, the proceeds of prior and future Revenue Bonds and Veterans G.O. Bonds, including the Winter 2001 Veterans G.O. Bonds, may be used to finance Contracts of Purchase before proceeds of the Offered Revenue Bonds. See "THE PROGRAM – Qualifying Veteran Status" for information regarding eligibility requirements for different moneys made available by the Department and APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments" for information regarding the amount of moneys expected to become available to finance Contracts of Purchase upon the issuance of the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds.

Excess Revenues (defined in "SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION – Definitions (Section 103)") can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, investment earnings and insurance receipts, and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. See "THE OFFERED REVENUE BONDS – Redemption – Information Regarding Prepayments" for additional information regarding prepayments of Contracts of Purchase.

All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or to any other permitted purpose depends on many factors, including applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings and Federal Tax Code requirements. See "THE OFFERED REVENUE BONDS – Redemption – Information Regarding Prepayments" for additional information regarding prepayments of Contracts of Purchase. Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. See APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information With Respect to Veterans G.O. Bonds and Revenue Bonds."

Information Regarding Prepayments

The Department's actual past prepayment experience for existing Contracts of Purchase is set forth in APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience." However, since the Department substantially reduced the interest rates on most existing Contracts of Purchase in January 1999, the prepayment experience reflected in the chart may not predict the future behavior of such Contracts of Purchase after the interest rate reduction.

For certain Revenue Bonds (not including the Offered Revenue Bonds) issued or to be issued after 1988, the Federal Tax Code prohibits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase after 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a \$250,000 *de minimis* amount. See "TAX MATTERS – Federal Tax Matters – Proposed Federal Tax Legislation."

The Federal Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of certain Revenue Bonds (not including the Offered Revenue Bonds). See APPENDIX G – "CERTAIN FEDERAL TAX CODE REQUIREMENTS – Other Requirements Imposed by the Federal Tax Code – Recapture Provision Applicable to Qualified Mortgage Bonds." Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of the applicable Revenue Bonds, for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

Redemption Notice

The Resolution requires that at least fifteen (15) but not more than ninety (90) days before a redemption date for Revenue Bonds, the Trustee must cause a notice of any such redemption to be mailed, first class prepaid, to registered owners of the Revenue Bonds which are the subject of the redemption at the addresses appearing on the registration books maintained by the Trustee, as Bond Registrar. In addition, if the notice of redemption is conditional, the notice must set forth in summary terms the conditions precedent to such redemption and that if such conditions shall not have been satisfied on or prior to the redemption date, said notice shall be of no force and effect and such Revenue Bonds will not be so redeemed. No defect in the notice of redemption or mailing thereof (including any failure to mail such notice) to any owner of Revenue Bonds will affect the validity of the redemption proceedings for any other owner of Revenue Bonds subject to such redemption.

BOOK-ENTRY ONLY SYSTEM

The information concerning DTC and DTC's book-entry system has been obtained from sources that the Department believes to be reliable, but the Department, the Trustee and the Underwriters take no responsibility for the accuracy or completeness thereof.

DTC will act as securities depository for the Offered Revenue Bonds. The Offered Revenue Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered Offered Revenue Bond certificate will be issued for each maturity of each Series of the Offered Revenue Bonds in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the

Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Direct and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Offered Revenue Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Revenue Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Revenue Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Revenue Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Revenue Bonds, except in the event that use of the book-entry system for the Offered Revenue Bonds is discontinued.

To facilitate subsequent transfers, all Offered Revenue Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Offered Revenue Bonds with DTC and their registration in the name of Cede & Co., or such other nominee, do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Revenue Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Revenue Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Neither the Department nor the Trustee will have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Offered Revenue Bonds.

Beneficial Owners of the Offered Revenue Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Offered

Revenue Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Revenue Bond documents. Beneficial Owners of the Offered Revenue Bonds may wish to ascertain that the nominee holding the Offered Revenue Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of a maturity of a Series of the Offered Revenue Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Revenue Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Department as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Revenue Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the Department, the Trustee, and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Offered Revenue Bonds.

Principal, premium and interest payments on the Offered Revenue Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Department or the Trustee, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Direct Participants and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Direct or Indirect Participants and not of DTC (nor its nominee), the Trustee or the Department, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee or the Department, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

The Department, the Trustee, and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Offered Revenue Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

If the Department and the Trustee determine not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Offered Revenue Bonds and the Department and the Trustee do not select another qualified security depository, the Trustee shall deliver physical Offered Revenue Bond certificates to the Beneficial Owners. The Offered Revenue Bonds may thereafter be transferred upon the books of the Department by the registered owners, in person or by authorized attorney, upon surrender of Offered Revenue Bonds

at the Office of the Trustee in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the Trustee and upon payment of any charges provided for in the Resolutions. Certificated Offered Revenue Bonds may be exchanged for Offered Revenue Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the Trustee in Sacramento, California, upon payment of any charges provided for in the Resolutions.

ESTIMATED APPLICATION OF OFFERED REVENUE BOND PROCEEDS

The sources of funds and the uses thereof (exclusive of accrued interest) in connection with the Offered Revenue Bonds, after expected transfers and exchanges, are expected to be approximately as set forth below.

SOURCES

Offered Revenue Bond proceeds	\$117,200,000
Available amounts in the 1943 Fund	<u>11,020,210</u>

TOTAL SOURCES	<u>\$128,220,210</u>
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USES

Payment of refunded bonds	\$117,200,000
Deposit to 2002 A Revenue Bond Series	
Proceeds Subaccount	5,903,653
Deposit to Bond Reserve Account	3,759,000
Costs of issuance	420,258
Underwriters' compensation	937,299

TOTAL USES:	<u>\$128,220,210</u>
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THE PROGRAM

General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 411,900 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds (including Revenue Bonds) and Veterans G.O. Bonds, combined with surplus revenues under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since Program inception. As of September 30, 2001, there were 31,256 Contracts of Purchase outstanding with a remaining principal balance of \$2,561,288,000. As of September 30, 2001 the Department had approximately 266 pending applications for Contracts of Purchase in the approximate total principal amount of \$40,000,000. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase" and "- Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof. The Veterans Code and the Department's implementation of the Program are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code allows the Department to finance Contracts of Purchase for:

(a) veterans who have served during one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

Amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. These amendments, together with various financial and programmatic changes implemented by the Department, have significantly increased the universe of potential eligible veterans. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

Federal Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of Federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX G - "CERTAIN FEDERAL TAX CODE REQUIREMENTS." Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund, certain proceeds of pre-Ullman (as defined below) Revenue Bonds and Veterans G.O. Bonds, and certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (the QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by Unrestricted Moneys). The Department has implemented a policy (which is subject to change) to make Unrestricted Moneys available for Earlier War Veterans, Vietnam Era Veterans, and Recent War Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements (defined below) do not apply to Contracts of Purchase financed by moneys derived exclusively from

proceeds of Veterans G.O. Bonds.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds other than pre-Ullman Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies certain requirements imposed by the Federal Tax Code principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements").

Allocation of Lendable Moneys

For veterans who qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department may select the source of funds to be used in its sole discretion. The Department's goal is to maximize the availability of Program benefits. Current policy is that (a) only those veterans who qualify only for Unrestricted Moneys (such as the Offered Revenue Bonds) will be funded from that source; and (b) veterans who qualify for both Qualified Mortgage Bonds Proceeds and Qualified Veterans Mortgage Bond Proceeds (such as the Winter 2001 Veterans G.O. Bonds) are allowed to select between the two funding sources.

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land sale contract between the Department and the veteran which is somewhat analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price." See "THE PROGRAM - Contracts of Purchase."

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is \$250,000 and for farms is \$300,000 (except that the limitation with respect to mobile homes located on or to be located on a leased or rented site in a mobile home park is \$70,000 and except that the maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The Federal Tax Code permits such maximums to be adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

Before 1998, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly, Farmers' Home Administration), or any private primary mortgage insurer. In 1998, the Department was approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for certain prior and all future Contracts of Purchase not guaranteed by the USDVA with loan-to-value ratios ("LTV") above 80%, from Radian. See "THE PROGRAM - Loan Insurance - Primary Mortgage Insurance." Certain Contracts of Purchase are not the subject of loan insurance or guarantees. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase."

The terms of the Contracts of Purchase are substantially identical, except for interest rates on Contracts of Purchase originated after January 1, 1999, regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to Federal Tax Code-mandated recapture provisions. In addition, the Federal Tax Code contains the QMB Loan Eligibility Requirements, which are numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the date of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess

of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan, and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements, but requires that 95% or more of the proceeds of the bond issue be used in full compliance with the loan eligibility restrictions.

Since the number and aggregate principal balance of Contracts of Purchase relating to farms and mobile homes, and Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase."

Many factors affect the ability or willingness of homebuyers to make mortgage loan payments and of potential homebuyers to borrow money to purchase homes. These factors include, among others, general economic conditions, interest rates, and costs of living.

Origination. The Veterans Code, in most cases, requires the veteran to make an initial payment of at least 2% of either the purchase price or the market value of the property, whichever is less. In the case of veterans who are ineligible for a full USDVA guaranty, Department policy requires the veteran to make an initial payment of 3% of either the purchase price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years for any other Contracts of Purchase. Pursuant to its policy, the Department issues all new Contracts of Purchase for terms of 30 years unless a shorter term is requested. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

In addition to the initial payment referred to in the prior paragraph, a Loan Origination Fee ("LOF") of 1% of the loan amount is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the mortgage broker through the escrow. Otherwise, the fee is retained by the Department. While the Department's field offices will continue to originate Contracts of Purchase, the Department expects the bulk of the Contracts of Purchase to be originated by mortgage brokers. After a preliminary screening in the field offices, applications will be forwarded to a centralized underwriting unit in Sacramento for processing. The mortgage brokers deal directly with the central underwriting, escrow and administrative staff in Sacramento. An appraisal fee of \$300 to \$425 is collected from the applicant and is paid directly to the appraiser upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with existing Contracts of Purchase. When a home improvement loan is approved, total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV ratio is much lower than 90%. Improvement loans

are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are disbursed by the Department directly to the contractors (or vendors) as the improvements are completed. A separate Contract of Purchase covering only the improvements is executed, bearing interest at the same rate as the veteran's existing Contract of Purchase. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is \$15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of \$50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time. Currently, less than one percent of the total principal balance of all Contracts of Purchase is derived from home improvement loans.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program for all Contracts of Purchase, including those not eligible for USDVA guarantees. Department procedures are consistent with those established by USDVA for its loan guaranty program.

The history of the Department's originations of Contracts of Purchase is set forth in APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Contracts of Purchase Origination and Principal Repayment Experience."

Servicing. All Contracts of Purchase are serviced by the Department. Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month. A \$10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days.

Prepayment Penalties. There are no prepayment penalties on any Contracts of Purchase.

Cancellations and Delinquencies. The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements and the requirements of Radian. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; however, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. If a schedule of liquidation has been agreed to with respect to a Contract of Purchase and the veteran makes all regularly scheduled payments and liquidation payments on a timely basis, the Contract of Purchase is not considered delinquent.

The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of Federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary, and is marketed through the Department's centralized repossession sales unit. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended (the "Soldier's and Sailor's Relief Act"). Under the Soldier's and Sailor's Relief Act, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding. The Department does not know how many of the veterans who have received

Contracts of Purchase qualify or could qualify for such relief and, therefore, cannot predict the financial impact of such relief on the 1943 Fund.

See APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans' Finance Committee of 1943 (the "Finance Committee"). Most of such Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 (the "pre-1999 Contracts of Purchase") bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for such pre-1999 Contracts of Purchase can be changed annually as deemed necessary. The effective date of a higher rate of interest on pre-1999 Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Finance Committee that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rates requirement for Contracts of Purchase originated on or after January 1, 1999; (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase; and (iii) allows the Department to modify such interest rates, or the methodology and timing for determining or modifying interest rates, from time to time, subject to the approval of the Board and the Finance Committee. The Department received approval to implement a flexible mechanism to provide for periodic adjustments of the interest rate on new Contracts of Purchase funded from Qualified Mortgage Bond Proceeds, Qualified Veterans Mortgage Bond Proceeds, and Unrestricted Moneys. As a result of such mechanism, interest rates for new Contracts of Purchase funded on and after September 1, 2001 are currently 6.00% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, 6.25% for Contracts of Purchase financed using Qualified Veterans Mortgage Bond Proceeds (such as the Winter 2001 Veterans G.O. Bonds), and 6.50% for Contracts of Purchase using Unrestricted Moneys (such as the Offered Revenue Bonds). Interest rates on Contracts of Purchase are expected to be established in the future based on various factors deemed appropriate by the Department, subject in all cases to the requirements of the resolution authorizing the issuance of Revenue Bonds (the "Revenue Bond Resolution") for the filing of Cash Flow Statements and conformance with Program Operating Procedures. As noted herein, the Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Cash Flow Statement consists of the conclusion by an authorized representative of the Department that projected revenues will be sufficient to provide for timely payment of principal of and interest on the Revenue Bonds and expenses, under each scenario included in the quantitative analysis which accompanies the Cash Flow Statement. See APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Selected Principal Flows with respect to Contracts of Purchase funded by both Veterans G.O. Bonds and Revenue Bonds."

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Relief Act. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the

period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). The Department does not know how many of the veterans who have received Contracts of Purchase qualify or could qualify for such relief and, therefore, cannot predict the financial impact of such relief on the 1943 Fund.

Loan Insurance

Since 1997, the Department has completed several programmatic changes, including obtaining loan insurance from a private primary mortgage insurer for certain existing Contracts of Purchase with high LTVs, and USDVA guarantees or private primary mortgage insurance for all new Contracts of Purchase (except mobile homes in parks, construction loans during the construction period, and home improvement loans) with LTVs above 80% up to 100%. In addition to the LOF and initial payment, the Department collects a funding fee of from 1.25% up to 3% of the Contract of Purchase amount, based on the LTV for each Contract of Purchase which exceeds an LTV of 80%. The fee may be paid in escrow by the buyer or seller, or it may be added to the base loan amount. Veterans described above who are ineligible for a full USDVA guaranty and therefore are obligated to make an initial 3% payment must advance a funding fee of up to 2% of the base loan amount to the Department at close of escrow, and the funding fee may not be added to the base loan amount. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is retained by the Department, and a portion of such funding fees is used by the Department to pay costs related to the Radian primary mortgage insurance. Although the Department has no current expectation that it will change its current policies regarding insurance and guarantees, it may change such expectations. Any change to the foregoing insurance and guaranty expectations could require an amendment to the Department's Program Operating Procedures and delivery of a new Cash Flow Statement. A significant principal amount of Contracts of Purchase, including Contracts of Purchase with LTVs above 80%, are not covered by loan insurance. See APPENDIX D - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA - Contracts of Purchase - Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

Primary Mortgage Insurance. The Department purchased from Radian a policy of primary mortgage insurance for a pool of certain prior Contracts of Purchase with LTVs above 80%. This Radian policy provides coverage on such pool back to February 1, 1998. The Department has purchased an additional policy of primary mortgage insurance from Radian which provides the same coverage as provided in the original policy, except that the Department now includes certain existing and all new Contracts of Purchase with 97% to 100% LTV ratios that are not qualified for USDVA guarantees (except mobile homes in parks, construction loans and home improvement loans, all of which continue to be covered by the Department). Under this second policy, Radian has committed to insure both new and existing Contracts of Purchase presented by the Department for coverage until the earlier of December 31, 2004 or when the aggregate principal amount of Contracts of Purchase insured under the second policy reaches \$1.6 billion. Each of the Radian policies provides for coverage for aggregate losses incurred on Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the Contracts of Purchase of the applicable pool. Under both Radian policies, once the applicable aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

**Radian Mortgage Insurance Coverage Ratios Subject to a
Deductible of 2% of the Originally Insured Balances of the
Contracts of Purchase in the Applicable Insured Pool**

<u>LTV Category</u>	<u>% of Coverage</u>
97.01% to 100.00%	35%
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

For information regarding the principal amount of Contracts of Purchase covered by the Radian policies, see APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase - Current Loan-to-Value Ratio of Contracts of Purchase."

USDVA Guaranty Program. The Department was approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guarantees for all Contracts of Purchase with an LTV of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, and contracts for the purchase of new homes not inspected by USDVA during construction. Also, a very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of (a) the veteran's available entitlement (a maximum of \$36,000, or if the original loan amount exceeds \$144,000, a maximum of \$50,750), or (b) (1) 50% of the original loan amount if such amount does not exceed \$45,000, (2) \$22,500 if the original loan amount is between \$45,000 and \$56,250, (3) the lesser of \$36,000 or 40% of the original loan amount, if such amount is between \$56,250 and \$144,000, or (4) the lesser of \$50,750 or 25% of the original loan amount, if such amount is in excess of \$144,000. The liability on the guaranty is reduced or increased pro rata with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security. For information regarding the amount of Contracts of

Purchase guaranteed by the USDVA, see APPENDIX D – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase – Current Loan-to-Value Ratio of Contracts of Purchase."

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policy have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by the Department or by insurance companies selected by the Department. Any change to the insurance requirements could require amending the Department's Program Operating Procedures.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments to veterans, up to a Department deductible. The Master Policy described below (the "Master Policy") provides \$100,000,000 coverage in excess of the Department deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by commercial insurers (the "provider"). The lead insurance company for the provider is Affiliated FM Insurance Company.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to the Department deductible, which is \$1,500,000 per occurrence or \$13,000,000 per policy year. If the total losses from a single occurrence exceed \$1,500,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed \$13,000,000, liability for the excess will be covered under the Master Policy. The coverage under the Master Policy extends to October 31, 2002. The Master Policy is an all-physical loss form.

Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to \$0.22 per \$100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

Disaster Indemnity Plan. The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood or earthquake. The deductible for flood losses is \$500 and the deductible for earthquake losses is \$500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of twelve insurance companies for a total of \$50,000,000 of coverage with a \$4,000,000 deductible per occurrence and in the

aggregate annually; \$100,000 per occurrence maintenance deductible thereafter. The 2001- 2002 one-year premium for this coverage is \$3,385,000.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of \$.95 per \$1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 2001 was \$18,480,576.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy is renewable annually.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund, the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by Pacific Life and Annuity Company ("Pacific Life") (previously PM Group Life Insurance Company). Effective February 1, 1998, after a competitive bidding process, the interim plan was replaced with a long-term life insurance and disability plan, also provided by Pacific Life. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented, with benefits equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his or her contract is paid off. Loss reserves for these obligations are actuarially based. A portion of the required loss reserves is maintained under a third-party administrator agreement and is shown in the financial statements for the 1943 Fund as deposits with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. See "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION."

As noted above, effective February 1, 1998, the Department implemented a new life and disability protection plan which is provided by Pacific Life. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving self-insured benefits as described in the preceding paragraph) under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage will continue unchanged for all currently insured Contract of Purchase holders up to age 60. For formerly insured holders of Contracts of Purchase under age 60, 100% of the loan balance is covered. Life insurance coverages at subsidized rates for those currently insured Contract of Purchase holders in the program over age 60 are limited to a maximum of the loan amount or \$75,000, if less, reducing in increments every 5 years to a maximum of \$5,000 after age 80. If they so desire, such Contract of Purchase holders can obtain, at commercial insurers' rates, coverage for loan balances in excess of such amounts. Holders of new Contracts of Purchase after February 1, 1998 are covered under a revised insurance plan. The Department continues to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health of the individual loan applicant. All new Contract of Purchase applicants must apply and must be provided the minimum life insurance coverage. Disability coverage for a period up to two

years is optional for new Contract of Purchase holders after February 1, 1998, but is a mandatory requirement for Contract of Purchase holders with Contracts of Purchase in existence prior to February 1, 1998. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months. Additional, full coverage, life insurance may also be purchased as an option by new Contract of Purchase holders. Spouse life insurance coverage is available as an option. The new plan is an experience rate plan subject to annual rating reviews of insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department has established a one-time \$5 million rate stabilization reserve, intended to minimize the impact of premium increases for Contract of Purchase holders. The Department will retain the principal amount of such \$5 million and any interest earnings on such amount as part of the 1943 Fund.

The Department's life and disability insurance program is the subject of a state audit report released in March 2001. See "THE DEPARTMENT - External Reviews of the Program." The Department is in the process of soliciting bids from providers to determine the premium cost of increasing the disability benefits for Contract of Purchase holders.

SUMMARY OF CERTAIN PROVISIONS OF THE RESOLUTION

The following is a summary of certain provisions of the Resolution. **This summary does not purport to be comprehensive and reference should be made to the Resolution for a full and complete statement of its provisions.**

Resolution to Constitute Contract (Section 101)

In consideration of the purchase and acceptance of any and all of the Bonds issued under the Resolution by those who shall own the same from time to time, the Resolution shall be deemed to be and shall constitute a contract between the Department, the Trustee and the owners of the Bonds, and the pledges made in the Resolution and the covenants and agreements in the Resolution set forth to be performed by the Department or the Trustee shall be for the equal benefit, protection and security of the owners of any and all of the Bonds, all of which, without regard to the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of any of the Bonds over any other of the Resolution, except as expressly provided in or permitted by the Resolution or by the applicable Series Resolution.

Pledge Effected by the Resolution (Section 102)

For the purpose of fixing and declaring the terms and conditions upon which the Bonds are to be issued, executed, delivered, secured and accepted by the owners of the Bonds, and in order to secure the payment of all Bonds at any time issued and Outstanding under the Resolution and the interest thereon according to their tenor, purport and effect, and in order to secure the performance and observance of all the covenants, agreements and conditions therein and in the Resolution contained, the Department has adopted the Resolution, has pledged, conveyed and assigned, and, subject to the subordination provisions in favor of other debt holders of the Department contained in the definition in the Resolution of Pledged Property, does by the

Resolution pledge, convey and assign the Pledged Property to the Trustee as security for the payment of the principal of, including redemption premium, if any, on the Bonds and the interest thereon for the equal and proportionate benefit and security, from time to time, of the owners of the Bonds, without preference, priority or distinction as to lien or otherwise, *except* as otherwise provided in the Resolution or as provided in an applicable Series Resolution, of any one Bond over any other Bond, by reason of priority in the issue, sale or negotiation thereof or otherwise, all in accordance with the terms of the Resolution.

Definitions (Section 103)

In the Resolution and any resolution supplemental to the Resolution the following terms shall have the following meanings:

"Account" means an Account (and any subaccounts therein) created by or pursuant to the Resolution or a Series Resolution.

"Accountant" means an independent certified public accountant or firm of independent certified public accountants selected by the Department, who may be the accountant or firm of accountants who regularly audit the books of the Department.

"Accrued Debt Service" means, as of any date of determination and, as the context of the Resolution requires, with respect to all Bonds and/or all Veterans G.O. Bonds, the sum of:

(a) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) hereof) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(b) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(c) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans G.O. Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

"Additional Bonds" means any additional Bonds issued pursuant to Section 209 of the Resolution.

"Amortized Value" means the purchase price of securities, excluding accrued interest, plus an amortization of any discount or less an amortization of any premium included in the purchase price. The premium or discount shall be amortized on an actuarial basis, such that the Amortized Value at any time equals the price at which the yield on a security equals the yield of such security as of its original purchase. In the case of an Investment Obligation callable at the option of the issuer thereof, the original yield and Amortized Value shall be computed on the assumption that, (i) for securities purchased at a premium, such security is redeemed as of the first possible

redemption date, provided, that after such redemption date, such value of the Investment Security shall be computed at par, or (ii) for securities purchased at a discount, such security is held to maturity.

"Applicable Fund Parity Percentage" means 50% or such other percentage set forth in the Program Operating Procedures. But see "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS - Maintenance of Fund Parity" for current percentage.

"Appreciated Amount" means with respect to a Deferred Interest Bond, (i) as of any date of computation with respect to any Deferred Interest Bond up to the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, an amount equal to the initial principal amount of such Deferred Interest Bond plus the interest accrued on such Deferred Interest Bond from the date of original issuance of such Deferred Interest Bond to the applicable interest payment date next preceding the date of computation or the date of computation if an applicable interest payment date, such increased amount to accrue at the rate per annum set forth in the Series Resolution authorizing such Deferred Interest Bond, compounded on each applicable interest payment date, plus, if such date of computation shall not be an applicable interest payment date, a portion of the difference between the Appreciated Amount as of the immediately preceding applicable interest payment date (or the date of original issuance if the date of computation is prior to the first applicable interest payment date succeeding the date of original issuance) and the Appreciated Amount as of the immediately succeeding applicable interest payment date, calculated based upon an assumption that the Appreciated Amount accrues in equal daily amounts on the basis set forth in the Series Resolution authorizing such Deferred Interest Bonds; and (ii) as of any date of computation on and after the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, the Appreciated Amount as of such current interest payment commencement date.

"Authorized Representative" or "Authorized Officer" means the Secretary of Veterans Affairs, Undersecretary of Veterans Affairs, Deputy Secretary of Operations, Deputy Secretary of Administration or any other authorized representative as from time to time may be designated by the Secretary in writing to the Trustee as authorized to act under the Resolution on behalf of the Department.

"Bond Act" means the Veterans' Revenue Debenture Act of 1970 (constituting Chapter 7 of Division 4 of the Veterans Code), as now in effect and as it may from time to time hereafter be amended or supplemented.

"Bondowner" or "owner of Bonds" or "Holder" or "Bondholder" means the registered owner of any registered Bond.

"Bond Registrar" means the Trustee as the party responsible for maintenance of the Bond registration books of the Department pursuant to Section 208 of the Resolution.

"Bond Reserve Account" means the Bond Reserve Account established pursuant to Section 401 of the Resolution.

"Bond Reserve Requirement" means, as of any particular date of calculation, an amount equal to the aggregate of all amounts established for all Series of Bonds Outstanding in the Series Resolutions authorizing the issuance of such Bonds, at least equal in the aggregate to three per centum (3%) of the aggregate Outstanding principal amount of the Bonds with interest rates fixed to the maturity thereof.

"Bonds" means Revenue Bonds.

"Cash Equivalent" means a Letter of Credit, Insurance Policy, Surety, Guarantee or other Security Arrangement (as defined and provided for in a Series Resolution providing for the issuance of Bonds or in a Supplemental Resolution), provided by an institution which has received a rating of its claims paying ability from each of the Rating Agencies at least equal to the then-existing respective rating on the Bonds or whose unsecured debt securities are rated at least the then-existing respective rating on the Bonds (or the highest rating of short-term obligations if the Cash Equivalent is a short-term instrument) by the Rating Agencies.

"Cash Flow Statement" means a Cash Flow Statement conforming to the requirements of Section 607 of the Resolution.

"Certificate of the Department" means an instrument in writing signed by an Authorized Representative.

"Committee" means the Veterans' Debenture Finance Committee created by the Bond Act.

"Contract of Purchase" means any contract of purchase entered into by the Department and a veteran or other eligible person covering any property (whether residential or otherwise) purchased or acquired by the Department with moneys in the 1943 Fund or any other obligation representing a program investment of such moneys irrespective of the form of such obligation.

"Costs of Issuance" means all items of expense payable or reimbursable directly or indirectly by the Department and related to the authorization, sale, issuance and remarketing of the Bonds, as certified by an Authorized Representative.

"Credit and Liquidity Support Expenses" means, with respect to a Series of Bonds or a series of Veterans G.O. Bonds (as the context requires), as set forth in a Series Resolution or Supplemental Resolution, or resolution of issuance governing such series of Veterans G.O. Bonds, respectively, the amounts necessary to pay any fees and reimbursement in connection with tender option features, letters of credit, standby bond purchase agreements, bond insurance and other forms of credit and liquidity support related thereto.

"Debt Service Year" means the year beginning on the second day of October and ending on the first day of October in the next succeeding year, or any other twelve-month period hereafter selected and designated as such in the Program Operating Procedures.

"Deferred Interest Bond" means any Bond designated as such by the Series Resolution authorizing the issuance of such Bond.

"Department Request" means a written request or direction of the Department signed by an Authorized Representative.

"Excess Revenues" means, as of any date of calculation, the amount of all Revenues held in the Revenue Account in excess of Accrued Debt Service (as adjusted for any use of Revenues contemplated at the time of such calculation).

"Expenses" means any moneys required by the Department to pay, or to be set aside to pay, the expenses of the Trustee and any expenses which the Department may lawfully pay from the 1943 Fund (whether or not related to the Bonds), except (i) as limited with respect to any Series of Bonds by the applicable Series Resolution, and (ii) that Credit and Liquidity Support Expenses shall not be included in the definition of "Expenses"; *provided, however*, that such expenses related to Cash Equivalents shall not be excluded.

"Fiscal Year" means the year beginning on the first day of July and ending on the last day of June in the next succeeding year, or any other twelve-month period selected and designated as the official fiscal year period of the Department.

"Fitch" means Fitch IBCA, Inc., and includes any successor thereto.

"Fund Parity" means, on any determination date, (A) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established under the Resolution, and (ii) the aggregate Outstanding principal amount of all Bonds and all Veterans G.O. Bonds (plus accrued interest) reduced by (B) allowances and reserves for loss coverage on Contracts of Purchase, loss coverage on properties subject to Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures.

"Government Obligations" means bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

"Investment Obligations" means, any of the following which at the time of purchase are legal investments under the laws of the State of California for moneys held under the Resolution and then proposed to be invested therein:

(1) Government Obligations;

(2) Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Banks, stock, bonds, debentures and other obligations of the Government National Mortgage Association or the Federal National Mortgage Association established under the National Housing Act as amended, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended;

(3) interest-bearing demand or time deposits in banks or savings and loan associations, which, to the extent they are not insured by federal deposit insurance, are collateralized by

securities eligible to secure public deposits in the State, or which are issued by an institution, the senior unsecured debt of which is rated in one of the top two rating categories of a Rating Agency;

(4) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or which are issued by an institution the senior unsecured debt of which is rated in one of the top two rating categories by a Rating Agency;

(5) repurchase agreements backed by or related to obligations described in (1) or (2) above with any institution whose unsecured debt securities are rated, or which agreements are rated, at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency;

(6) (1) investment agreements, secured (by collateralization, guaranty or otherwise) or unsecured, with any institution, or fully guaranteed by any institution, whose unsecured debt securities are rated at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency, or (2) any investment agreement that is secured (by collateralization, guaranty or otherwise), to such extent that the investment agreement itself is the subject of such a rating or the Bonds are the subject of written confirmation from a Rating Agency that investment of amounts in such an investment agreement will not cause the outstanding rating of the Bonds by such Rating Agency to be withdrawn, downgraded or suspended;

(7) commercial paper (having original maturities of not more than 180 days) rated in the highest rating category by a Rating Agency;

(8) direct and general obligations of or obligations unconditionally guaranteed by any state or political subdivision thereof, the payment of the principal of and interest on which the full faith and credit of the state or such political subdivision is pledged, and certificates of participation in any such obligations (which obligations may be subject to annual appropriations), which obligations or certificates of participation, respectively, are rated at least equal to the then existing rating of the Bonds by a Rating Agency;

(9) investments in any mutual fund the portfolio of which is limited to Investment Obligations, including any proprietary mutual fund of the Trustee or co-Trustee for which the Trustee or co-Trustee or an affiliate is investment advisor or provided other services to such mutual fund and receives reasonable compensation for such services (and if such mutual fund consists solely of Government Obligations, then such fund will constitute "Government Obligations" for the purposes of the Resolution);

(10) obligations of any state, political subdivision, political corporation or agency, the payment of principal, redemption price, if any, and interest on which is irrevocably secured by Government Obligations; and

(11) deposits in the Surplus Money Investment Fund in the Treasury of the State.

Provided, that it is expressly understood that the definition of Investment Obligations shall be, and be deemed to be, expanded, or new definitions and related provisions shall be added to

the Resolution by a Supplemental Resolution adopted and filed in accordance with Section 1001(j) of the Resolution thus permitting investments with different characteristics from those permitted which the Department deems from time to time to be in the interests of the Department to include as Investment Obligations;

For purposes of the definition, "institution" means an individual, partnership, corporation, trust or unincorporated organization, or a government or agency, instrumentality, program, account, fund, political subdivision or corporation thereof.

If the rating of any Investment Obligation purchased pursuant to the Resolution is downgraded, suspended or withdrawn by any Rating Agency, the Trustee is not required to sell such Investment Obligation but may retain the same under the Resolution.

"Liquidation/Insurance Proceeds" means amounts representing proceeds of (1) the sale or other disposition of any property subject to any Contract of Purchase, whether upon cancellation of said Contract of Purchase (on account of default or any other cause) or for any other cause, exclusive of amounts so recovered and required by law, contract or resolution of the Department to be otherwise applied, and (2) compensation for losses incurred with respect to the property subject to any Contract of Purchase from the proceeds of condemnation, title insurance, hazard insurance, or primary or pool insurance of the Contracts of Purchase (including Veterans Administration guarantees), exclusive of amounts recovered in respect of such losses to the extent required to be otherwise applied pursuant to applicable law, contract or resolution of the Department.

"Loan Loss Account" means the Loan Loss Account established pursuant to Section 401 of the Resolution.

"Loan Loss Requirement" means, as of any particular date of calculation, an amount established in the current Cash Flow Statement which, when added to the Bond Reserve Requirement, shall not exceed ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding or such larger amount as may be provided in a Supplemental Resolution adopted pursuant to Section 1001(m) of the Resolution.

"Mandatory Sinking Account Payments" means, as of any particular date of calculation, with respect to the Term Bonds of any Series and maturity, the amount of money required to be applied on any applicable date to the redemption prior to maturity or the purchase of the Term Bonds, except as such requirement shall have been previously reduced by the principal amount of any Term Bonds of such Series and maturity with respect to which such Mandatory Sinking Account Payments are payable which are to be purchased or redeemed (except out of Mandatory Sinking Account Payments). Mandatory Sinking Account Payments may be established as fixed dollar amounts or as method(s) of calculation thereof.

"Monthly Debt Service Requirement" means, as of any date of determination, one-twelfth (1/12) of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

"Moody's" means Moody's Investors Service, Inc., and includes any successor thereto.

"1943 Fund" means the Veterans' Farm and Home Building Fund of 1943, established in the Treasury of the State by Section 988 of the Veterans Code.

"Outstanding" as used in relation to Bonds means, as of any date, all Bonds theretofore authenticated and delivered by the Trustee under the Resolution, except:

- (a) any Bond deemed paid in accordance with Section 411(b) of the Resolution;
- (b) any Bond canceled by, or delivered for cancellation to, the Trustee because of payment at maturity or redemption or purchase prior to maturity;
- (c) any Bond deemed paid in accordance with the provisions of Section 303 of the Resolution;
- (d) any Bond deemed paid in accordance with the provisions of Section 1101 of the Resolution; and
- (e) any Bond in lieu of or in substitution for which another Bond shall have been authenticated and delivered pursuant to Section 211 of the Resolution, unless proof satisfactory to the Trustee is presented that any Bond for which a Bond in lieu thereof or in substitution therefor shall have been authenticated and delivered is held by a bona fide purchaser, as that term is defined in Article Eight of the Uniform Commercial Code of the State, as amended, in which case both the Bond so substituted and replaced and the Bond or Bonds authenticated and delivered in lieu thereof or in substitution therefor shall be deemed Outstanding.

"Pledged Property" means (a) an undivided interest in the assets of the 1943 Fund, other than any GO Bond Series Bond Proceeds Subaccount, which undivided interest shall be secondary and subordinate to the rights of the holders of Veterans G.O. Bonds to receive payment of debt service thereon from amounts in the 1943 Fund under any general obligation veterans bond act, (b) any amounts held in the Bond Reserve Account, and (c) any amounts in the Loan Loss Account, except amounts in any Rebate Account and *except* that the pledge established in a Series Resolution may be limited in purpose and time, as set forth in the Series Resolution.

"Primary Contract of Purchase Coverage" means coverage in the form of primary mortgage insurance, guaranty (including by United States Department of Veterans Affairs guaranty) or otherwise of loss from Contract of Purchase defaults as provided in the Program Operating Procedures.

"principal" means (a) as such term references the principal amount of a Deferred Interest Bond or Deferred Interest Bonds, the Appreciated Amount thereof, and (b) as such term references the principal amount of any other Bond or Bonds, the principal amount at maturity of such Bond or Bonds.

"Proceeds Account" means the Proceeds Account established pursuant to Section 401 of the Resolution.

"Program" means the finance program of the Department pursuant to which the Department will issue the Bonds and Veterans G.O. Bonds and apply the proceeds thereof to finance Contracts of Purchase.

"Program Acts" means the Veterans' Farm and Home Purchase Act of 1943 (constituting Article 3 of Chapter 6 of Division 4 of the Veterans Code) and the Veterans' Farm and Home Purchase Act of 1974 (constituting Article 3.1 of Chapter 6 of Division 4 of the Veterans Code), as now in effect and as they may from time to time hereafter be amended or supplemented.

"Program Operating Procedures" means, at any time, the Department's program operating procedures governing the discretionary activities of the Department, in the then current form, as described in Section 606 of the Resolution.

"Rating Agency" means, at any time, any bond rating agency, including Fitch, Moody's and S&P, that shall have rated any of the Bonds at the request of the Department and shall be maintaining ratings on such Bonds at such time.

"Rating Confirmation" means, with respect to any action or financial condition described in the Resolution, written confirmation from each of the Rating Agencies that the taking of such action or the existence of such financial condition shall not cause the outstanding ratings by such respective Rating Agencies of all Bonds which are not rated based solely on the credit of a bond insurer or other guarantor to be withdrawn, downgraded or suspended.

"Rebate Account" means any Account of that name established by the Department pursuant to Section 401(c) of the Resolution.

"Redemption Price" means, with respect to a Bond or portion thereof, the portion of the principal amount of such Bond or portion plus the applicable premium, if any, payable upon redemption thereof in the manner contemplated in accordance with its terms pursuant to the provisions of the Resolution and any Series Resolution.

"Restricted Recoveries" means, as set forth or referenced in the Series Resolution authorizing a Series of Bonds or in a resolution of issuance authorizing a series of Veterans G.O. Bonds, or as otherwise designated in the Program Operating Procedures, that portion of prepayments and scheduled repayments of principal on Contracts of Purchase financed (directly or indirectly) by or credited to such Series of Bonds or series of Veterans G.O. Bonds, respectively, to the extent such amounts are required by the Tax Code or by the terms of such Series Resolution or resolution of issuance, respectively, to be applied to a redemption of Bonds or Veterans G.O. Bonds.

"Revenue Account" means the Revenue Account established pursuant to Section 401 of the Resolution.

"Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the Revenue Account pursuant to Section 502 of the Resolution, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account

or the Loan Loss Account, and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any Series Resolution.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, and includes any successor thereto.

"Series Certificate" means a Certificate of the Department which shall be dated as of the date of sale and shall be executed (or re-executed in final form) and delivered on the date of issuance of the applicable Series of Bonds.

"Series Proceeds Subaccounts" means, collectively, the Revenue Bond Series Proceeds Subaccounts and the GO Bond Series Proceeds Subaccounts.

"Series Recycling Subaccounts" means, collectively, the Revenue Bond Series Recycling Subaccounts and the GO Bond Series Recycling Subaccounts.

"Series Resolution" means a Supplemental Resolution of the Committee authorizing the issuance of a Series of Bonds and including any Series Certificate delivered pursuant thereto.

"Series Restricted Recoveries Subaccounts" means, collectively, the Revenue Bond Series Restricted Recoveries Subaccounts and the GO Bond Series Restricted Recoveries Subaccounts.

"Series Revenue Subaccounts" means, collectively, the Revenue Bond Series Revenue Subaccounts and GO Bond Series Revenue Subaccounts.

"State" means the State of California.

"Supplemental Contract of Purchase Coverage" means the coverage, if any, of loss from Contract of Purchase defaults provided in the Program Operating Procedures which supplements any Primary Contract of Purchase Coverage.

"Supplemental Resolution" means any resolution of the Committee supplementing or amending the Resolution.

"Tax Code" means applicable provisions of the Internal Revenue Code of 1954, as amended, and the Internal Revenue Code of 1986, as amended, and the applicable regulations thereunder.

"Term Bonds" means the Bonds with respect to which Sinking Account Requirements have been established.

"Veterans Code" means the Military and Veterans Code of the State of California.

"Veterans Debenture Fund" means the Veterans Debenture Revenue Fund established in the Treasury of the State by Section 1003.11 of the Veterans Code.

"Veterans General Obligation Bonds" means, as of any given time, general obligation bonds of the State the proceeds of which were required to be deposited in the 1943 Fund (or returned to the General Fund or in the Pooled Money Investment Account in the State Treasury in repayment of amounts withdrawn from said General Fund or the Pooled Money Investment Account and deposited in the 1943 Fund) and which are at such given time outstanding. Veterans General Obligation Bonds are referred to in this Official Statement as "Veterans G.O. Bonds."

Miscellaneous Definitions (Section 104)

Unless the context shall otherwise indicate, words which import the singular shall include the plural, and words which import the plural shall include the singular. The word "person" shall mean any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof. The words "of the Resolution," "herein," "hereto," "by the Resolution" and "hereunder" refer to the entire Resolution. The words "interest payment date" mean with respect to any Series of Bonds, the interest payment date(s) established in the applicable Series Resolution, regardless of whether the referenced Bonds are interest-bearing or not. Any reference to a rating category shall mean the category published by a Rating Agency without reference to numbered or lettered annotations or pluses and minuses.

Authentication of Bonds (Section 205)

Only such of the definitive Bonds as shall have endorsed thereon a certificate of authentication substantially in the form set forth in the applicable Series Resolution, duly executed by the Trustee, shall be entitled to any benefit or security under the Resolution. No definitive Bond shall be valid or obligatory for any purpose unless and until such certificate of authentication shall have been duly executed by the Trustee, and such certificate of the Trustee upon any such Bond shall be conclusive evidence that such Bond has been duly authenticated and delivered under the Resolution. The Trustee's certificate of authentication on any definitive Bond shall be deemed to have been duly executed if signed by an authorized officer of the Trustee, but it shall not be necessary that the same officer sign the certificate of authentication on all of the Bonds that may be issued under the Resolution at any one time.

Exchange of Bonds (Section 206)

Subject to, and in accordance with, Section 207 of the Resolution, Bonds, upon surrender thereof at the principal office of the Trustee in Sacramento California, together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee, may, at the option of the registered owner thereof, be exchanged for an equal aggregate principal amount of Bonds of like tenor and of the same Series (and subseries, if applicable) and maturity, bearing interest at the same rate, of any denomination or denominations authorized by the Resolution.

Negotiability, Registration and Registration of Transfer of Bonds (Section 207)

The transfer of any Bond may be registered only upon the books kept for the registration of, and registration of transfers of, Bonds upon surrender thereof to the Trustee together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee. Upon any such registration of transfer of a Bond, the

Department shall execute and the Trustee shall authenticate and deliver in exchange for such Bond a new Bond or Bonds, registered in the name of the transferee, in any denomination or denominations authorized by the Resolution, in an aggregate principal amount equal to the principal amount of such Bond of like tenor and of the same Series (and subseries, if applicable) and maturity and bearing interest at the same rate.

Issuance of the Bonds (Section 209)

Each Series Resolution authorizing the issuance of a Series of Bonds shall specify and determine:

- (a) The authorized principal amount of such Series of Bonds;
- (b) The purposes for which such Series of Bonds are being issued which shall be one or more of the following purposes: (i) the financing of Contracts of Purchase, (ii) the making of such deposits in amounts, if any, required by the Resolution or the Series Resolution to be paid into various Accounts or the direct payment of Costs of Issuance, or (iii) the refunding of all or any part of the Bonds of any Series (including any Bonds not deemed Outstanding under the Resolution pursuant to Section 411(b)) or, to the extent permitted by law, Veterans G.O. Bonds, including the payment of any redemption premium thereon (or premium, to the extent permitted by law, included in the purchase price if purchased in lieu of redemption);
- (c) The maturity date or dates, the amounts of each maturity, and the interest payment dates of the Bonds of such Series;
- (d) The interest payment dates, and rate or rates, of the Bonds of such Series or method of determining the same;
- (e) The denomination or denominations of, and the manner of dating, numbering and lettering the Bonds of each Series;
- (f) In the case of Term Bonds, if any, provision for Mandatory Sinking Account Payments;
- (g) The Redemption Price or Redemption Prices, if any, the time or times and the terms and conditions upon which the Bonds of such Series may be redeemed prior to their maturities, including without limitation the method of selection for redemption as among maturities;
- (h) The amounts to be deposited from the proceeds of such Series of Bonds in the Accounts created and established by the Resolution and the Series Resolution;
- (i) That *notwithstanding* any other provision of the Series Resolution, upon issuance, sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Bond Reserve Account so that the amount in such fund shall be at least equal to the Bond Reserve Requirement calculated immediately after the delivery of such Series of Bonds;

(j) That *notwithstanding* any other provision of the Series Resolution, upon sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Loan Loss Account so that the amount in such fund shall be at least equal to the Loan Loss Requirement calculated immediately after the delivery of such Series of Bonds;

(k) The manner in which Bonds of such Series are to be sold and provisions for the sale thereof;

(l) The form of any credit enhancement or liquidity support for such Series of Bonds;
and

(m) Any other provisions deemed advisable by the Department not in conflict with the provisions of the Resolution.

Said Bonds shall be executed substantially in the form and manner set forth in the Resolution and shall be deposited with the Trustee for authentication, but before said Bonds shall be authenticated and delivered by the Trustee, there shall be on file with the Trustee the following:

(a) A copy, duly certified by an Authorized Representative, of the Resolution and the Series Resolution for such Series of Bonds;

(b) A Certificate of the Department to the effect that no Event of Default shall have occurred and then be continuing;

(c) An opinion of nationally recognized bond counsel stating in the opinion of such counsel that (i) the Resolution and the applicable Series Resolution have been duly adopted and are valid and binding upon the Department and (ii) said Bonds are valid and legally binding special obligations of the Department secured in the manner and to the extent set forth in the Resolution and the applicable Series Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein;

(d) A Cash Flow Statement conforming to the requirements of Section 607 of the Resolution;

(e) With respect to refunding Bonds, a certificate of an Authorized Representative stating that the proceeds (excluding accrued interest but including any premium) of such refunding Bonds, together with any moneys to be withdrawn from the Bond Reserve Account by the Trustee, and any other moneys which have been made available to the Trustee for such purposes, and the principal of and the interest on the investment of such proceeds or any such moneys, will be not less than an amount sufficient to pay the principal of and the redemption premium, if any, on the Bonds to be refunded and the interest which will become due and payable on or prior to the date of their payment or redemption, the expenses in connection with such refunding and to make any required deposits to the Bond Reserve Account and the Loan Loss Account and specifying transfers, if any, from the Series Proceeds Subaccount applicable to the Series of Bonds to be refunded and the refunding Bonds;

(f) With respect to refunding Bonds, if all or part of the refunded Bonds are to be redeemed prior to maturity, irrevocable instructions from an Authorized Representative of the Department to the Trustee to redeem the applicable Bonds;

(g) A Rating Confirmation; and

(h) A request and authorization to the Trustee on behalf of the Department, signed by an Authorized Representative, to authenticate and deliver the Bonds to the purchaser or purchasers therein identified upon payment to the Trustee for the account of the Department of the purchase price therefor.

When the documents mentioned in clauses (a) to (h), inclusive, of Section 209 shall have been filed with the Trustee and when the Bonds described in the Series Resolution mentioned in clause (a) above shall have been executed and authenticated as required by the Resolution, the Trustee shall deliver such Bonds at one time to or upon the order of the purchaser or purchasers named in the request and authorization mentioned in clause (h) of Section 209, but only upon payment to the Trustee of the purchase price of said Bonds. The Trustee shall be entitled to rely upon such request and authorization as to the amount of such purchase price.

Simultaneously with the delivery of such Bonds the Trustee shall deposit or credit the proceeds of said Bonds into the applicable Revenue Bond Series Proceeds Subaccount of the Proceeds Account. Unless otherwise provided in the applicable Series Resolution, the Trustee shall apply such proceeds together with any other available funds, as follows:

(i) an amount shall be transferred to and deposited to the credit of the Bond Reserve Account such that the amount on deposit in such Account will at least equal the Bond Reserve Requirement (with respect to refunding Bonds, after giving effect to the refunding);

(ii) an amount shall be transferred to and deposited to the credit of the Loan Loss Account such that the amount on deposit in such Account will at least equal the Loan Loss Requirement (with respect to refunding Bonds, after giving effect to the refunding); and

(iii) an amount to be transferred to and deposited into any Account or for any purpose not referred to in clauses (i) or (ii) above as provided in the applicable Series Resolution.

Transfers Outside Book-Entry System (Section 214)

In the event (i) the Securities Depository (*i.e.*, initially, DTC) determines not to continue to act as Securities Depository for any Series of the Bonds, or (ii) the Department and the Trustee determine that the Securities Depository shall no longer so act and the Department delivers a written certificate to the Trustee to that effect, then the Department will discontinue the book-entry system with the Securities Depository with respect to such Series. If the Department and the Trustee determine to replace the Securities Depository with another qualified securities depository, the Department shall prepare or direct the preparation of a new, single, separate, fully registered bond for each of the maturities of the Bonds of such Series, registered in the name of such successor or substitute qualified securities depository or its nominee, or make such other arrangements acceptable to the Department and the Securities Depository as are not inconsistent with the terms of the Resolution or any Supplemental Resolution. If the Department and the Trustee fail to identify another qualified securities depository to replace the Securities Depository,

then the Bonds of such Series shall no longer be restricted to being registered in the registration books of the Trustee in the name of the Nominee, but shall be registered in whatever name or names the Bondowner of Bonds transferring or exchanging Bonds shall designate in accordance with the Resolution. Notwithstanding anything in Section 214 of the Resolution to the contrary, the book-entry system may not be discontinued within the period commencing 15 days prior to the date of mailing a notice of redemption and ending on the redemption date specified in such notice.

Payments and Notices to the Nominee (Section 215)

Notwithstanding any other provision of the Resolution or any Supplemental Resolution to the contrary, so long as any Bond is registered in the name of the Nominee, all payments with respect to principal of, premium, if any, and interest on such Bond and all notices with respect to such Bond shall be made and given, respectively, as provided in the applicable Representation Letter or as otherwise instructed by the Securities Depository.

Effect of Calling for Redemption (Section 303)

On the date so designated for redemption if the conditions precedent, if any, to such redemption have been satisfied, any required notice which has not been waived having been given in the manner and under the conditions in the Resolution above provided, the Bonds or portions of Bonds so called for redemption shall become and be due and payable at the Redemption Price provided for redemption of such Bonds or portions thereof on such date, and, if sufficient money or Government Obligations (the principal of and interest on which will provide sufficient money for payment of the Redemption Price and the accrued interest) are held by the Trustee in trust for the owners of the Bonds or portions thereof to be redeemed, as provided in the Resolution, such Bonds or portions thereof shall cease to be Outstanding under the provisions of the Resolution, interest on the Bonds or portions of Bonds so called for redemption shall cease to accrue, such Bonds or portions of Bonds shall cease to be entitled to any benefit or security under the Resolution and the owners of such Bonds or portions of Bonds shall have no rights in respect of the Resolution, except to receive payment of the Redemption Price thereof and the accrued interest thereon to the date of redemption and, to the extent provided in Section 304 of the Resolution, to receive Bonds for any unredeemed portion of Bonds.

Establishment of Accounts (Section 401)

- (a) The Resolution creates the following Accounts within the 1943 Fund:

Proceeds Account

Revenue Bond Series Proceeds Subaccounts

Revenue Bond Series Recycling Subaccounts

GO Bond Series Proceeds Subaccounts

GO Bond Series Recycling Subaccounts

Revenue Account

Revenue Bond Series Restricted Recoveries Subaccounts

Revenue Bond Series Revenue Subaccounts

GO Bond Series Restricted Recoveries Subaccounts

GO Bond Series Revenue Subaccounts

(b) The Resolution creates the following Accounts within the Veterans Debenture Fund and designated as set forth below:

Bond Reserve Account

Series Bond Reserve Subaccounts

Loan Loss Account

Series Loan Loss Subaccounts

(c) Additional Accounts (including for the purpose of depositing amounts required to be rebated to mortgagors or the United States, *i.e.*, a Rebate Account) may be created and designated in Series Resolutions. Any Series Proceeds Subaccount, Series Recycling Subaccount, Series Restricted Recoveries Subaccount and Series Revenue Subaccount may be established with respect to more than one Series of the Bonds, or more than one series of Veterans G.O. Bonds, as set forth in the Series Resolution or Supplemental Resolution or any resolution of issuance governing a series of Veterans G.O. Bonds. Each such Account established with respect to Bonds shall be held by the Trustee, in trust, separate and apart from all other funds of the Department, for the purposes provided in this Resolution, *provided* that in Series Resolutions, the Department may provide for the deposit of amounts in Accounts, which amounts shall be subject to the lien of this Resolution only for the purposes and period of time set forth in the applicable Series Resolution.

Proceeds Account (Section 402)

(a) Upon the issuance of a Series of Bonds or a series of Veterans G.O. Bonds, unless otherwise provided in the applicable Series Resolution or resolution of issuance governing such Veterans G.O. Bonds, respectively, the Trustee shall establish a Series Proceeds Subaccount and a Series Recycling Subaccount within the Proceeds Account applicable to such Series of Bonds or series of Veterans G.O. Bonds. The Trustee shall deposit amounts received in connection with the issuance of Bonds or Veterans G.O. Bonds into the Proceeds Account or any such Subaccount in the amount(s) and at the time(s) set forth in the Series Resolution or resolution of issuance, respectively, authorizing the issuance thereof. Amounts shall also be deposited in the Proceeds Account from a transfer of funds from the Revenue Account pursuant to the provisions of Section 403(c)(11) of the Resolution. Amounts on deposit in the Proceeds Account may be transferred between various Series Proceeds Subaccounts and Series Recycling Subaccounts, as set forth in the Program Operating Procedures.

(b) Moneys in the Proceeds Account shall be withdrawn or transferred therefrom in accordance with law upon requisition of the Department for the purpose of carrying out the provisions of the Bond Act and the Program Acts, including by entering into Contracts of Purchase, and by paying administrative expenses of the Department, including Costs of Issuance.

(c) The Trustee shall transfer from the Proceeds Account any amount specified by the Department from time to time in a Department Request for the purpose of redeeming or purchasing Bonds or Veterans G.O. Bonds or for the purpose of funding the Bond Reserve Account as provided in the applicable Series Resolution, or resolution of issuance, and Program Operating Procedures.

(d) The Trustee shall transfer any amount deposited in a Series Recycling Subaccount to the related Series Restricted Recoveries Subaccount or to the related Series Revenue Subaccount, upon a Department Request in the amount and at the time(s) stated in such Department Request.

(e) Moneys held for the credit of the Proceeds Account shall be transferred to be applied for payment of Bonds or Veterans G.O. Bonds pursuant to Section 410 of the Resolution.

Revenue Account; Application of Revenues (Section 403)

(a) The Department shall transfer all Revenues to the Trustee for deposit in the Revenue Account upon the Department's identification and receipt thereof. Upon transfer, the Department shall identify the amount of Restricted Recoveries included in such Revenues and deposit the same, unless otherwise provided in the applicable Series Resolution or any resolution of issuance governing a series of Veterans G.O. Bonds, in the related Series Restricted Recoveries Subaccount. The balance shall be deposited in the related Series Revenue Subaccount.

(b) Pursuant to a Department Request, based on the Department's determination that certain Revenues previously deposited in a Series Revenue Subaccount constitute Restricted Recoveries, the Trustee shall transfer Revenues in an amount equal to and representing such Restricted Recoveries from the Series Revenue Subaccount to the related Series Restricted Recoveries Subaccount (if any).

(c) From time to time as required or as otherwise directed by Department Request, the Department shall cause to be transferred, applied, or retained all Revenues in the Revenue Account (not including Series Restricted Recoveries Subaccounts, which shall be governed by Section 409 of the Resolution) for the following purposes (subject, in the case of any deficiency in available Revenues to meet the requirements of one or more of clauses (1) through (6), to the provisions as to deficiency contained in Section 410):

(2) In accordance with the applicable Series Resolution, to transfer to any Rebate Account, or otherwise to the U.S. Treasury, the amount(s) if any, specified by Department Request;

(3) From the GO Bond Series Revenue Subaccounts, to reimburse the General Fund for amounts previously paid out of the General Fund (and not previously reimbursed pursuant to this provision) for principal of and interest on the Veterans G.O. Bonds of the related series (together with interest at the same rate as borne by said bonds, compounded

semiannually, from the due date of such principal and interest to the date of such reimbursement);

(4) From the GO Bond Series Revenue Subaccounts, to transfer to the General Fund the amount of the principal of and interest then due on the Veterans G.O. Bonds of the related series and the amount of Credit and Liquidity Support Expenses then due and related thereto;

(5) From the Revenue Bond Series Revenue Subaccounts, to pay interest due on the Bonds of the related Series;

(6) From the Revenue Bond Series Revenue Subaccounts, to pay principal (including by operation of Mandatory Sinking Account Payments) due on the Bonds of the related Series;

(7) From the Revenue Bond Series Revenue Subaccounts, to pay any Credit and Liquidity Support Expenses then due and related to the Bonds of the related Series;

(8) From the Revenue Bond Series Revenue Subaccounts, upon Department Request and (without Department Request) at least once every month, to deposit to the credit of the Bond Reserve Account an amount sufficient to cause the amount on deposit in said Account to equal the Bond Reserve Requirement (to be allocated among any Revenue Bond Series Bond Reserve Subaccounts in accordance with the Program Operating Procedures);

(9) From the Revenue Bond Series Revenue Subaccounts, pursuant to the terms of a Series Resolution upon the issuance of a Series of Bonds, to transfer such amount as is required to cause the amount in the Loan Loss Account to equal the Loan Loss Requirement;

(10) From all Series Revenue Subaccounts pursuant to Program Operating Procedures to transfer an amount to the Department for deposit to any operating or other account, free and clear of the lien of the Resolution, equal to Expenses specified in a Department Request as contemplated by the Program Operating Procedures;

(11) From the GO Bond Series Revenue Subaccounts, on the first day of each month, to accumulate in the GO Bond Series Revenue Subaccounts collectively (in such respective allocations made at such times as are required by the Program Operating Procedures), an amount equal to Accrued Debt Service on the Veterans G.O. Bonds of all series;

(12) From any Series Revenue Subaccount, upon Department Request, to transfer amounts for credit to the related Series Recycling Subaccount; and

(13) With respect to amounts constituting Excess Revenues or Restricted Recoveries, to redeem any Series of Bonds or series of Veterans G.O. Bonds upon Department Request and in accordance with the provisions of a Series Resolution or Supplemental Resolution, or resolution of issuance governing such Veterans G.O. Bonds, respectively.

(d) Revenues in the Revenue Account shall be applied to the purchase of Bonds at the times, in the manner and for the purposes set forth in Section 406 of the Resolution.

(e) Amounts on deposit in the Revenue Account upon Department Request may be transferred between any Series Restricted Recoveries Subaccount or Series Revenue Subaccount and any other Series Restricted Recoveries Subaccount or Series Revenue Subaccount, as set forth in the Program Operating Procedures.

Interest (Section 404)

In payment of interest on Bonds, the Trustee shall remit (or other method of transfer acceptable to the Department and to any Securities Depository) (i) by mail to each owner of Bonds the amounts required for paying the interest on such Bonds as such interest becomes due and payable and (ii) payment for any Credit and Liquidity Support Expenses relating to such Bonds as described in Section 403(c)(6) of the Resolution. An Authorized Representative of the Department shall advise the Trustee regarding the amount of any such Credit and Liquidity Support Expenses and when payment is due.

Principal (Section 405)

(a) **Principal Payments.** The Trustee shall set aside in the Revenue Account for remittance to Bondowners the amounts required for paying the principal of all Bonds as such principal becomes due and payable.

(b) **Mandatory Sinking Account Payments Redemption.** Amounts on deposit in any Revenue Bond Series Revenue Subaccount prior to being applied in satisfaction of Mandatory Sinking Account Payments shall be applied as applicable to the purchase of Term Bonds of the related Series then Outstanding subject to Mandatory Sinking Account Payments on the next date such payments are scheduled as provided in this paragraph. The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase the Term Bonds or portions of Term Bonds of each Series stated to mature on the next maturity date or to be redeemed pursuant to Mandatory Sinking Account Payments for Term Bonds of such Series then Outstanding at a price not to exceed the Redemption Price (plus accrued interest to the date of redemption) which would be payable on the next redemption date to the Owners of such Term Bonds under the provisions of the applicable Series Resolution if such Term Bonds or portions of Term Bonds should be called for redemption on such date. *Provided, however,* that, subject to applicable law, *notwithstanding* the maximum purchase price set forth in the preceding sentence, if at any time the investment earnings on the moneys in the Revenue Account equal to the Mandatory Sinking Account Payments for the next date such payments are scheduled shall be less than the interest accruing on the Bonds to be redeemed on such date from such Mandatory Sinking Account Payments, then the Trustee may pay a purchase price for any such Bond in excess of the Redemption Price which would be payable on the next redemption date to the owner of such Bond under the provisions of the applicable Series Resolution, if an Authorized Representative certifies to the Trustee that the amount paid in excess of said Redemption Price is expected to be less than the interest which is expected to accrue on said Bond less any investment earnings on such available moneys during the period from the settlement date of the proposed purchase to the redemption date. The Trustee shall pay the interest accrued on such Term Bonds or portions of Term Bonds to the date of settlement therefor from the Revenue Account. *Notwithstanding* the foregoing, no such purchase shall be made by the Trustee after the giving of notice of redemption by the Trustee.

(c) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of the Resolution. Upon retirement of any Term Bonds by purchase or redemption pursuant to the provisions of Section 405 of the Resolution, the Trustee shall file with the Department a statement identifying such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Redemption (Section 406)

(a) The Trustee shall apply all amounts in Revenue Bond Series Restricted Recoveries Subaccounts, and all moneys otherwise set aside in the Revenue Account for the redemption of Bonds pursuant to Section 403(c)(12) of the Resolution, to the purchase or redemption of Bonds issued under the provisions of the Resolution, as follows:

(1) The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase Bonds or portions of Bonds then Outstanding, whether or not such Bonds or portions of Bonds shall then be subject to redemption, at a price not to exceed the Redemption Price (plus accrued interest, if any, to the date of redemption) which would be payable on the next redemption date to the owners of such Bonds if such Bonds or portions of Bonds should be called for redemption on such date from the moneys in the respective Account. Such maximum purchase price may be exceeded in accordance with the proviso in Section 405(b) of the Resolution. The Trustee shall pay the interest accrued on such Bonds to the date of settlement therefor from the Revenue Account, but no such purchase shall be contracted for by the Trustee after the giving of notice by the Trustee that such Bonds have been called for redemption except from moneys other than the moneys set aside for the redemption of such Bonds.

(2) The Trustee, having endeavored to purchase Bonds pursuant to subsection (1) of this subsection (a), shall call for redemption, on the earliest practicable date on which Bonds are subject to redemption from such moneys, such amount (computed on the basis of Redemption Prices) of Bonds as will exhaust the moneys set aside for such redemption, as nearly as may be practicable.

(b) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of the Resolution. Prior to calling Bonds or portions of Bonds for redemption, the Trustee shall set aside the respective amounts required for paying the interest on and the Redemption Price of the Bonds or portions of Bonds so called for redemption. Upon the retirement of any Bonds under Section 406 of the Resolution by purchase or redemption, the Trustee shall file with the Department a statement briefly describing such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Bond Reserve Account (Section 407)

(a) Moneys held for the credit of the Bond Reserve Account shall be transferred by the Trustee to be applied for payment of Bonds pursuant to Section 410 of the Resolution.

(b) Moneys held for the credit of the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement upon Department Request shall be transferred to the Loan Loss Account, the Revenue Account or the Proceeds Account.

(c) A Series Resolution may provide that the Bond Reserve Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with any discussion in the Resolution of "moneys" on deposit in or held for the credit of the Bond Reserve Account, "moneys" shall be deemed to include said Cash Equivalents.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Bond Reserve Account to equal the Bond Reserve Requirement from available amounts in the 1943 Fund.

Loan Loss Account (Section 408)

(a) Pursuant to the Program Operating Procedures, moneys held for the credit of the Loan Loss Account as of any date upon Department Request shall be transferred to the Revenue Account, the Bond Reserve Account, the Proceeds Account or any GO Bond Series Revenue Subaccount.

(b) A Series Resolution may provide that the Loan Loss Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with any discussion in the Resolution of "moneys" on deposit in or held for the credit of the Loan Loss Account, "moneys" shall be deemed to include said Cash Equivalents.

(c) Moneys held for the credit of the Loan Loss Account shall be transferred by the Trustee to be applied for payment of Bonds, pursuant to Section 410 of the Resolution.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Loan Loss Account to equal the Loan Loss Requirement from available amounts in the 1943 Fund.

(e) To the extent set forth in a Department Request, the Trustee shall apply amounts in the Loan Loss Account to remedy shortfalls in recoveries on Contracts of Purchase financed by or otherwise allocable to the Veterans G.O. Bonds of any series.

Restricted Recoveries (Section 409)

Upon the issuance of a Series of Bonds or series of Veterans G.O. Bonds, if so required by the terms of the Series Resolution or resolution of issuance governing the Veterans G.O. Bonds, the Trustee shall establish a Series Restricted Recoveries Subaccount within the Revenue Account applicable to such Series of Bonds or series of Veterans G.O. Bonds. If the Trustee does not receive a Department Request with respect to a mandatory redemption from Restricted Recoveries set forth in a Series Resolution, the Trustee shall apply Restricted Recoveries in an

amount sufficient to accomplish such mandatory redemption to a redemption of Bonds (subject to any other priority set forth in the applicable Series Resolution) on a pro rata basis, as nearly as practicable, from among each maturity of the Series (and subseries, if applicable) of Bonds which financed the related Contracts of Purchase. Upon Department Request, the Trustee shall transfer amounts in any Series Restricted Recoveries Subaccount to the related Series Revenue Subaccount.

Deficiencies in Debt Service (Section 410)

In the event that amounts in the Revenue Account shall be insufficient on any interest payment date or principal payment date for the Bonds or the Veterans G.O. Bonds to pay the principal of and interest on such Bonds, or provide for payment with respect to Veterans G.O. Bonds pursuant to the provisions of Section 403(c)(2) or (3) of the Resolution in each case if payment is due and unpaid on such date, whether at the stated payment or maturity date or by the retirement thereof by Mandatory Sinking Account Payments (or sinking account retirement with respect to the Veterans G.O. Bonds) therefor, the Trustee shall withdraw amounts from the following Accounts in the following order of priority to the extent necessary to eliminate such deficiency; provided, however, that no amounts shall be used for such purpose to the extent that such amounts have been set aside for the payment of Bonds or Veterans G.O. Bonds which have been identified for purchase pursuant to Section 403 or 406 of the Resolution or called for redemption, and no amounts on deposit in the Proceeds Account shall be used for such purpose to the extent that the Department is contractually obligated to enter into Contracts of Purchase acceptable for financing with such amounts:

(a) With respect to deficiencies in payments related to Veterans G.O. Bonds, in the following order of priority:

- (i) GO Bond Series Recycling Subaccounts;
- (ii) GO Bond Series Proceeds Subaccounts;
- (iii) GO Bond Series Restricted Recoveries Subaccounts;
- (iv) Revenue Bond Series Revenue Subaccounts;
- (v) Revenue Bond Series Recycling Subaccounts;
- (vi) Revenue Bond Series Proceeds Subaccounts; and
- (vii) Revenue Bond Series Restricted Recoveries Subaccounts.

(b) With respect to deficiencies in debt service related to Bonds, in the following order of priority:

- (i) Revenue Bond Series Recycling Subaccounts;
- (ii) Revenue Bond Series Proceeds Subaccounts;
- (iii) Revenue Bond Series Restricted Recoveries Subaccounts;

- (iv) GO Bond Series Revenue Subaccounts;
- (v) GO Bond Series Recycling Subaccounts;
- (vi) GO Bond Series Proceeds Subaccounts;
- (vii) GO Bond Series Restricted Recoveries Subaccounts;
- (viii) Loan Loss Account; and
- (ix) Bond Reserve Account.

Moneys Held in Trust (Section 411)

(a) All moneys which the Trustee shall have withdrawn or set aside for the purpose of payment of any of the Bonds secured by the Resolution, either at the maturity thereof or upon call for redemption, shall be held in trust for the respective owners of such Bonds and such moneys shall not be subject to lien or attachment by any creditor of the Department or the Trustee. Any moneys which shall be so set aside by the Trustee and which shall remain unclaimed by the owners of such Bonds for the period of two (2) years after the date on which such Bonds or the interest thereon shall have become due and payable shall be paid to the Department or to such officer, board or body as may then be entitled by law to receive the same, and thereafter the owners of such Bonds shall look only to the Department or to such officer, board or body, as the case may be, for payment and then only to the extent of the amounts so received without any interest thereon, and the Trustee shall have no responsibility with respect to such moneys.

(b) If sufficient money or Government Obligations (the principal of or interest on which will provide sufficient money for payment of the principal amount or accrued interest on the Bonds on their maturity date or each date thereafter that they become due by redemption or otherwise) are held by the Trustee in trust for the Owners of Bonds, such Bonds shall cease to be Outstanding under the provisions of the Resolution, interest on the Bonds which have matured shall cease to accrue, such Bonds shall cease to be entitled to any benefit or security under the Resolution, and the owners of such Bonds shall have no rights in respect thereof, except to receive payment of the principal amount thereof and accrued interest thereon to the maturity date. Notwithstanding any provision of the Resolution to the contrary, the Department may issue refunding Bonds to refund the liabilities remaining on any such Bonds, despite their characterization for other purposes as not Outstanding under the Resolution.

Security for Deposits (Section 501)

All money deposited with a co-Trustee in any Account created under the Resolution shall, unless invested in Investment Obligations in accordance with Section 502 (except, to the extent applicable, the last paragraph of Section 502) of the Resolution, to the extent such deposits are in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other Federal agency, be continuously secured (if permitted by law), for the benefit of the Department and the owners of the Bonds either (a) by lodging with a bank or trust company selected by the Department as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit as collateral security, Government Obligations or,

with the approval of the Department, other marketable securities eligible as security for the deposit of trust funds under regulations of the Comptroller of the Currency of the United States of America, having a market value at all times (exclusive of accrued interest) not less than the amount of such deposit, or (b) if the furnishing of security as provided in clause (a) of Section 501 of the Resolution is not permitted by applicable law, then in such other manner as may then be required or permitted by applicable State or Federal laws and regulations regarding the security for, or granting a preference in the case of, the deposit of trust funds; *provided, however*, that it shall not be necessary, *except* as otherwise expressly provided, for the Trustee to give security for any money which shall be represented by obligations purchased under the provisions of Article V of the Resolution as an investment of such money.

Investment of Moneys (Section 502)

The Revenue Bond Series Proceeds Subaccounts, Series Recycling Subaccounts, Series Restricted Recoveries Subaccounts, Series Revenue Subaccounts, Loan Loss Account and Bond Reserve Account shall, as nearly as is practicable, be fully and continuously invested or reinvested in Investment Obligations.

Any Investment Obligations so purchased in any Account shall be deemed at all times to be part of such Account. Any interest paid on the investment in any Account (*except* any Rebate Account) shall be credited to the Revenue Account and thereafter treated as Revenues. Any interest paid on the investment of any Rebate Account shall be credited to such Rebate Account. Any profit or loss resulting from such investment shall be credited to or charged against the Account. The Trustee shall sell or present for redemption any obligations so purchased whenever it shall be necessary so to do in order to provide money to meet any payment or transfer from any such Account. Neither the Trustee nor the Department shall be liable or responsible for any loss resulting from any such investment.

Covenant Against Encumbrances (Section 605)

The Department covenants that, except as expressly permitted in the Resolution, it will not sell, convey, mortgage, encumber or otherwise dispose of the money held for the credit of any Account created under the Resolution except the pledge created by the Resolution and any interest or right to which such pledge is by its terms secondary and subordinate or take any other action which would adversely affect the security of the Bondowners stated in the Resolution.

Program Operating Procedures (Section 606)

(a) The Department shall have on file with the Trustee at all times during which Bonds are Outstanding current Program Operating Procedures accompanied by a Counsel's Opinion that the same are consistent with the provisions of the Resolution.

(b) Upon adoption of Program Operating Procedures, the Department shall thereafter administer the Program and perform its obligations under the Resolution in accordance in all material respects with the Program Operating Procedures. Any action taken by the Department with respect to Contracts of Purchase, Bonds and Pledged Property shall be deemed a representation and warranty by the Department under the Resolution that such action is in conformance with any provision of the current Program Operating Procedures applicable thereto.

(c) The Program Operating Procedures may be amended only if (1) a Cash Flow Statement is delivered to the Trustee, and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on the Bonds from the gross income of the holders thereof for federal income tax purposes.

Cash Flow Statements (Section 607)

(a) The Department shall file with the Trustee a current Cash Flow Statement (i) upon adoption of each Series Resolution and each Supplemental Resolution; (ii) upon issuance of any series of Veterans G.O. Bonds; (iii) when required pursuant to any Series Resolution or Supplemental Resolution; (iv) upon any change in the Program Operating Procedures; and (v) whenever required pursuant to the provisions of Section 608 of the Resolution. The Department may file a new or amended Cash Flow Statement conforming to the requirements of Section 607 of the Resolution at any time. Any Cash Flow Statement shall be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

(b) A Cash Flow Statement shall consist of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Bonds and Expenses, under each of the scenarios included in the cash flow projections attached to the Resolution. The Cash Flow Statement shall include each scenario included in the immediately prior Cash Flow Statement except as may be required by any Rating Agency in connection with a Rating Confirmation. A Cash Flow Statement shall (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account and the Loan Loss Account as of the stated starting date of the projection, (ii) reflect all the significant transactions that have occurred in the period commencing with such starting date and ending with a date no more than ninety (90) days prior to the date of such projections, (iii) be consistent with the Resolution and (iv) assume compliance with the Program Operating Procedures.

(c) The Cash Flow Statement shall set forth for each scenario included therein the sets of assumptions on which it is based including, without limitation, the following:

(i) the timing and terms of issuance or remarketing of Bonds and Veterans G.O. Bonds;

(ii) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;

(iii) the timing and amounts of the receipt of payments of scheduled principal or and interest on Contracts of Purchase;

(iv) the timing and amounts of prepayments on Contracts of Purchase;

(v) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;

(vi) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will not be subject to an investment agreement;

(vii) the performance by the Department's counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds;

(viii) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and

(ix) the Loan Loss Requirement.

(d) If any Cash Flow Statement shall show that projected Revenues shall be insufficient to provide for timely payments of interest on and principal of the Bonds and Expenses, the Department shall not be in default under the Resolution but shall take all reasonable actions to eliminate such deficiency. The Department shall be precluded from taking the actions described or referenced in clauses (i) through (iv) of subsection (a) of the first paragraph of this section – "Cash Flow Statements" – if the Cash Flow Statement on file with the Trustee in accordance with the requirements of the first paragraph of this section shall show that the taking of such action shall cause a deficiency to occur or shall increase any existing deficiency.

Maintenance of Fund Parity (Section 608)

The Department shall cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals the Applicable Fund Parity Percentage* (provided that any Applicable Fund Parity Percentage which is less than 50% shall be the subject of a Rating Confirmation) of the then Outstanding aggregate principal amount of Bonds, all Excess Revenues shall thereafter be applied to redeem Bonds of the Series and in the manner reflected in the current Cash Flow Statement until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such 50% (or such other percentage) level; provided, however, that no such Cash Flow Statement and no such redemption shall be required under the Resolution if the Department shall have provided a Rating Confirmation to the Trustee. But see "SECURITY AND SOURCES OF PAYMENT OF THE REVENUE BONDS – Maintenance of Fund Parity" for the current percentage.

Tax Covenants (Section 609)

The Department shall at all times perform the applicable tax covenants contained in any applicable Series Resolution. In addition, the Department shall not amend the interest rates on any existing Contracts of Purchase unless the Department shall have provided the Trustee with an opinion of nationally recognized bond counsel to the effect that such action will not impair any exclusion of interest on the Bonds issued with the intent that such interest be excluded from gross income for federal income tax purposes. The Department shall prohibit any person (or any related

*Currently, the Applicable Fund Parity Percentage is 25%. Such Applicable Fund Parity Percentage has been subject to Rating Agency Confirmation. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS - Maintenance of Fund Parity."

person, as defined in Section 147(a)(2) of the Tax Code) for whom the Department may finance Contracts from purchasing Bonds of any other obligations issued by the Department to carry out the purposes of the Program in an amount related to the amount of the Contracts to be financed under the Program for such person by the Department.

Books and Records (Section 611)

(a) The Trustee shall keep proper books of record and account in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocations and applications of all moneys received by the Trustee under the Resolution, and such books shall be available for inspection by the Department and any Bondowner during business hours, upon reasonable notice and under reasonable conditions.

(b) The Department shall keep proper books of records and account for all its transactions, other than those recorded in the books maintained by the Trustee pursuant to subsection (a) of Section 611 of the Resolution, and such books shall be available for inspection by the Trustee and any Bondowner during business hours and upon reasonable notice.

Annual Audit, Report and No-Default Certificate (Section 612)

By the first day of the tenth month after the end of each Fiscal Year, the Department shall furnish to the Trustee (i) a statement of the revenues and expenses and of the changes in the fund balances during the previous Fiscal Year, in each case with respect to the 1943 Fund, the Bond Reserve Account and the Loan Loss Account, certified to by an Accountant, and (ii) a certificate from an Authorized Representative stating that there is no current Event of Default and that no Event of Default occurred during the preceding Fiscal Year (or if there has been an Event of Default, providing the details of the Resolution and describing the steps the Department took, or is taking, to cure such Event of Default).

Program Covenants (Section 614)

The Department shall from time to time, with all practical dispatch and in a sound and economical manner consistent in all respects with the Bond Act, the Program Acts, the Resolution and all other applicable laws and regulations and with sound banking practices and principles, use and apply the amounts held in the 1943 Fund and available therefor to the financing of Contracts of Purchase and to other uses permitted under the Resolution and the law, and shall take all steps, actions and proceedings reasonable and necessary in the judgment of the Department to enforce the terms, covenants and conditions of each Contract of Purchase.

Issuance of Additional Obligations and Subordinate Obligations (Section 615)

The Department, so long as any Bonds shall be Outstanding under the Resolution, shall not issue any bonds, notes or other evidences of indebtedness, other than the Bonds, secured by any pledge of or other lien or charge on the Pledged Property nor shall the Department create or cause to be created any lien or charge on the Pledged Property, other than the lien and pledge created under the Resolution and other than the rights of the State or the holders of the Veterans G.O. Bonds. Nothing contained in Section 615 of the Resolution shall prevent the Department from issuing any bonds, notes or other evidences of indebtedness which are payable from or secured by a lien and pledge on the Pledged Property provided that payment of such evidences

of indebtedness and such lien and pledge shall be in all respects subordinate to the provisions of the Resolution and the lien and pledge created by the Resolution and any such evidences of indebtedness shall contain an appropriate recital with respect to such subordination.

Events of Default Defined (Section 702)

Each of the following events is by the Resolution declared an "Event of Default," that is to say: If

(a) payment of the principal or Redemption Price of any of the Bonds shall not be made when the same shall become due and payable, either at maturity or by proceedings for redemption or otherwise; or

(b) payment of any installment of interest on any of the Bonds shall not be made when the same shall become due and payable; or

(c) the entry of a decree or order for relief by a court having jurisdiction in the premises in respect of the Department in an involuntary case under the Federal bankruptcy laws, as now or thereafter constituted, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator (or similar official) of the Department or for any substantial part of its property, or ordering the winding-up or liquidation of its affairs and the continuance of any such decree or order unstayed and in effect for the period of 60 consecutive days; or

(d) the commencement by the Department of a voluntary case under the Federal bankruptcy laws, as constituted under the Resolution or hereafter amended, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or the consent by it to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or other similar official) of the Department or for any substantial part of its property or the making by it of any assignment for the benefit of creditors, or the taking of action by the Department in furtherance of any of the events under Section 702 of the Resolution; or

(e) failure by the Department to pay, when due or within any applicable grace period, any amount owing on account of indebtedness for money borrowed or for deferred purchases of property, or the failure by the Department to observe or perform any covenant or undertaking on its part to be observed or performed in any agreement evidencing, securing or relating to such indebtedness, resulting, in any such case, in an event of default or acceleration by the holder of such indebtedness of the date on which such indebtedness would otherwise be due and payable; or

(f) the Department defaults in the due and punctual performance of any other covenants or agreements contained in the Bonds or in the Resolution and such default continues for 90 days after written notice requiring the same to be remedied shall have been given to the Department by the Trustee, which may give such notice in its discretion and shall give such notice at the written request of the owners of not less than twenty per centum (20%) in aggregate principal amount of Bonds then Outstanding; *provided, however*, that so long as following such notice the Department is diligently taking actions to remedy such default, such default shall not be an Event of Default.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer, as the provider of the respective financial guaranty insurance policies with respect to the 1998 Series A Bonds and the 2001 Series A Bonds and as provider of the Financial Guaranty Insurance Policy, will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Enforcement of Remedies (Section 704)

Upon the happening and continuance of any Event of Default specified in Section 702 of the Resolution, then and in every such case the Trustee may, and upon the written direction of the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding under the Resolution shall, proceed, subject to the provisions of Section 802 of the Resolution, to protect and enforce its rights and the rights of the Bondowners under applicable laws or under the Resolution by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, either for the specific performance of any covenant or agreement contained in the Resolution or in aid or execution of any power in the Resolution granted or for the enforcement of any proper legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce such rights.

Regardless of the happening of an Event of Default, the Trustee may, and, subject to Section 802 of the Resolution, if requested in writing by the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding, shall institute and maintain such suits and proceedings as it may be advised shall be necessary or expedient (i) to prevent any impairment of the Pledged Property by any acts which may be unlawful or in violation of the Resolution or of any Series Resolution or (ii) to preserve or protect the interest of the Bondowners, *provided* that such request is in accordance with law and the provisions of the Resolution and, in the sole judgment of the Trustee, is not unduly prejudicial to the interests of the owners of Bonds not making such request.

If a covenant is set forth in a Series Resolution, limitations on the remedies available upon an Event of Default related to such covenant may be set forth in said Series Resolution.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Pro Rata Application of Funds (Section 706)

Anything in the Resolution to the contrary notwithstanding, if at any time the money in the Accounts maintained under the Resolution (other than any Rebate Account) shall not be sufficient to pay the principal of or interest on the Bonds as the same shall become due and payable such money, together with all amounts then on deposit in the 1943 Fund other than Veterans G.O. Bonds proceeds, together with any money then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in Article

VII or otherwise, shall be applied, following the satisfaction of any payments due to the Trustee under the provisions of Section 802 and 805 of the Resolution, as follows:

(a) Except in the case of amounts on deposit in the Bond Reserve Account and the Loan Loss Account and interest, profit or other income derived from the investment of such amounts, for transfer to the General Fund in the State Treasury in accordance with and at the times stated in Sections 403(c)(2) and (3) of the Resolution.

(b) After application pursuant to clause (a) of Section 706 of the Resolution, all such money shall be applied:

First: to the payment to the persons entitled thereto of all installments of interest on Bonds (*except* interest on overdue principal) then accrued and unpaid in the chronological order in which such installments of interest accrued and, if the amount available shall not be sufficient to pay in full any particular daily installment, then to the payment, ratably, according to the amounts due on such daily installment, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

Second: to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (*except* Bonds called for redemption for the payment of which money is held pursuant to the provisions of the Resolution) in the order of their stated payment dates, with interest on the principal amount of such Bonds at the respective rates specified in the Resolution from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of the Bonds by their stated terms due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, with such payment being made to owners of Bonds, and then to the payment of such principal, ratably, according to the amount of such principal due on such date, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

Third: to the payment of the interest on and the principal of the Bonds, to the purchase and retirement of Bonds and to the redemption of the Bonds, all in accordance with the provisions of Article III of the Resolution.

The provisions of subsection (a) of Section 706 of the Resolution are in all respects subject to the provisions of Section 701 of the Resolution.

(c) Whenever money is to be applied by the Trustee pursuant to the provisions of Section 706 of the Resolution, such money shall be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such money available for application and the likelihood of additional money becoming available for such application in the future; the deposit of such money with any paying agent, or otherwise setting aside such money, in trust for the proper purpose shall constitute proper application by the Trustee; and the Trustee shall incur no liability whatsoever to the Department, to any Bondowner or to any other person for any delay in applying any such money, so long as the Trustee acts with reasonable diligence, having due regard to the circumstances, and ultimately applies the same in

accordance with such provisions of the Resolution as may be applicable at the time of application by the Trustee. Whenever the Trustee shall exercise such discretion in applying such money, it shall fix the date (which shall be an interest payment date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate of the fixing of any such date, and shall not be required to make payment to the owner of any Bond until such Bond shall be surrendered to the Trustee for appropriate endorsement, or for cancellation if fully paid.

Owners of Majority in Principal Amount of Bonds May Control Proceedings (Section 708)

Anything in the Resolution to the contrary *notwithstanding*, the owners of a majority in principal amount of the Bonds then Outstanding under the Resolution shall have the right, subject to the provisions of Section 802 of the Resolution, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Resolution or exercising any trust or power conferred upon the Trustee, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Resolution, and the Act and, in the sole judgment of the Trustee, is not unduly prejudicial to the interests of Bondowners not joining in such direction and *provided, further*, that nothing in Section 708 of the Resolution shall impair the right of the Trustee in its discretion to take any other action under the Resolution which it may deem proper and which is not inconsistent with such direction by Bondowners.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Restrictions Upon Actions by Individual Bondowner (Section 709)

No owner of any of the Bonds shall have any right to institute any suit, action or proceeding in equity or at law on any Bond or for the execution of any trust under the Resolution or for the enforcement of any remedy under the Resolution unless such owner previously shall have given to the Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted, and unless, also, the owners of not less than fifteen per centum (15%) in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Resolution or to institute such action, suit or proceeding in its or their name, and *unless*, also, there shall have been offered to the Trustee reasonable security and indemnity against the costs, expenses and liabilities to be incurred therein or by the Resolution, and the Trustee shall have refused or neglected to comply with such request within a reasonable time; and such notification, request and offer of indemnity are by the Resolution declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers and trusts of the Resolution or to any other remedy under the Resolution; *provided, however*, that *notwithstanding* the foregoing provisions of Section 709 of the Resolution and without complying therewith, the owners of not less than twenty per centum

(20%) in aggregate principal amount of the Bonds then Outstanding may institute any such suit, action or proceeding in their own names for the benefit of all owners of Bonds under the Resolution. It is understood and intended that, *except* as otherwise provided in the Resolution, no one or more owners of the Bonds by the Resolution secured shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Resolution, or to enforce any right under the Resolution except in the manner in the Resolution provided, that all suits, actions and proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Resolution and for the benefit of all owners of such Outstanding Bonds, and that any individual right of action or other right given to one or more of such owners by law is restricted by the Resolution to the rights and remedies provided in the Resolution.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Waiver of Defaults (Section 713)

The Trustee may, and upon written direction of the owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall, waive any default which in their opinion shall have been remedied before the entry of final judgment or decree in any suit, action or proceeding instituted by them under the provisions of the Resolution or before the completion of the enforcement of any other remedy under the Resolution, but no such waiver shall extend to or affect any other existing or any subsequent default or defaults or impair any rights or remedies consequent thereon.

Notice of an Event of Default (Section 714)

The Trustee shall mail to the Department and to all Bondowners written notice of the occurrence of any Event of Default set forth in Section 702 of Article VII of the Resolution within thirty (30) days after the Trustee shall have received written notice thereof from the Department, subject to the provisions of Section 708 of the Resolution, that any such Event of Default shall have occurred. The Trustee shall not, *however*, be subject to any liability to any Bondowner by reason of a failure to mail any such notice.

Acceptance of Trusts (Section 801)

(a) The Treasurer of the State shall act as trustee for the Department and the owners of the Bonds to receive and disburse all Revenues and other moneys applicable to the payment of the principal of or interest on the Bonds, including moneys in the 1943 Fund and the Veterans Debenture Fund, and otherwise to hold all the offices and to perform all the functions and duties provided in the Resolution to be held and performed by the Trustee, including acting as Bond Registrar pursuant to Section 208 of the Resolution. For purposes of Article VIII of the Resolution only, the term "Trustee" does not include any co-Trustee appointed pursuant to Section 801 of the Resolution.

(b) Upon the occurrence and continuance of an Event of Default, the Department shall, upon the request of the Trustee or of the owners of twenty percent (20%) in aggregate principal

amount of the Bonds at the time Outstanding, appoint a co-Trustee to represent and enforce the rights of the owners of the Bonds during the continuance of such or any other concurrent Event of Default.

(c) The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Resolution. The Trustee and the co-Trustee shall, during the continuance of any Event of Default (which has not been cured), exercise such of the rights and powers vested in the Trustee and co-Trustee by the Resolution, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

(d) The Department may at any time or from time to time appoint one or more Paying Agents, in addition to the Trustee and the co-Trustee, for the purpose of paying the principal or Redemption Price of and the interest on the Bonds of any Series. Each Paying Agent shall signify its acceptance of the duties and obligations imposed on it by the Resolution by executing and delivering to the Department and to the Trustee a written acceptance of the Resolution. The Department may remove any Paying Agent at any time by giving written notice of such removal to such Paying Agent and to the Trustee. Any Paying Agent may at any time resign by giving notice of such resignation to the Department. In the event of the resignation or removal of any Paying Agent, such Paying Agent shall pay over, transfer, assign and deliver any moneys held by it to its successor or, if there be no successor then appointed, to the Trustee. The Department shall give prompt notice to Bondowners of the acceptance of appointment by any successor Paying Agent.

Trustee or Co-Trustee Entitled to Indemnity (Section 802)

The Trustee or co-Trustee shall be under no obligation to institute any suit, or to take any remedial proceeding under the Resolution, or to enter any appearance or in any way defend in any suit in which it may be named as a defendant, or to take any steps in the execution of the trusts created by the Resolution or in the enforcement of any rights and powers under the Resolution, until it shall be indemnified to its satisfaction against any and all costs and expenses, outlays and counsel fees and other reasonable disbursements, and against all liability; the Trustee or co-Trustee may, nevertheless, begin suit, or appear in and defend suit, or do anything else in its judgment proper to be done by it as such Trustee or co-Trustee, without indemnity, and in such case the Department shall reimburse the Trustee or co-Trustee for all costs and expenses, outlays and counsel fees and other reasonable disbursements properly incurred in connection therewith.

Limitation on Obligations and Responsibilities of Trustee or Co-Trustee (Section 803)

The Trustee or co-Trustee shall be under no obligation (a) to effect or maintain insurance or to renew any policies of insurance to inquire as to the sufficiency of any policies of insurance carried by the Department, (b) to report, or make or file claims or proof of loss for, any loss or damage insured against or which may occur or (c) to keep itself informed or advised as to the payment of any taxes or assessments, or to require any such payment to be made. The Trustee or co-Trustee shall be under no obligation to record or file the Resolution, or any other security instruments and financing statements, or continuation statements with respect thereto, except pursuant to directions from the Department, in form and substance satisfactory to the Trustee or co-Trustee, set forth in a Department Request. The Trustee or co-Trustee shall have no

responsibility in respect of the validity, sufficiency, due execution or acknowledgment by the Department of this Resolution, or, except as to the authentication thereof, in respect of the validity of the Bonds or the due execution or issuance thereof. The Trustee or co-Trustee shall be under no obligation to see that any duties imposed in the Resolution upon the Department or any party other than itself, or any covenants herein contained on the part of any party other than itself to be performed, shall be done or performed, and the Trustee or co-Trustee shall be under no obligation for failure to see that any such duties or covenants are so done or performed.

Compensation and Indemnification of Trustee and Co-Trustee (Section 805)

The Department shall pay, from the Pledged Property, to the Trustee and co-Trustee reasonable compensation for all services performed by it under the Resolution and also all its reasonable expenses, charges and other disbursements and those of its attorneys, agents and employees incurred in and about the administration and execution of the trusts created by the Resolution and the performance of its powers and duties under the Resolution, and from such source only, shall indemnify and save the Trustee and co-Trustee harmless against any liabilities which it may incur in the exercise and performance of its powers and duties under the Resolution.

Notice of Default (Section 807)

Except upon the happening of any Event of Default specified in clauses (a) and (b) of Section 702 of the Resolution, the Trustee or co-Trustee shall not be obliged to take notice or be deemed to have notice of any Event of Default, unless specifically notified in writing of such Event of Default by the Department or by the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds secured by the Resolution and then Outstanding.

Trustee or Co-Trustee Protected in Relying on Certain Documents (Section 810)

The Trustee and co-Trustee shall be protected and shall incur no liabilities in acting or proceeding, or in not acting or not proceeding, in good faith, reasonably and in accordance with the terms of the Resolution, upon any resolution, order, notice, request, consent, waiver, certificate, statement, affidavit, requisition, bond or other paper or document which it shall in good faith reasonably believe to be genuine and to have been adopted or signed by the proper board or person to have been prepared and furnished pursuant to any of the provisions of the Resolution, or upon the written opinion of any attorney, engineer or accountant believed by the Trustee or co-Trustee to be qualified in relation to the subject matter, and the Trustee or co-Trustee shall be under no duty to make any investigation or inquiry as to any statement contained or matters referred to in such instrument. The Trustee or co-Trustee shall not be under any obligation to see to the recording or filing of the Resolution.

Resignation and Removal of Co-Trustee Subject to Appointment of Successor (Section 811)

No resignation or removal of the co-Trustee and no appointment of a successor co-Trustee pursuant to Article VIII of the Resolution shall become effective until the acceptance of appointment by the successor co-Trustee under Section 814 of the Resolution.

Resignation of Co-Trustee (Section 812)

Subject to Section 811 of the Resolution, the co-Trustee may resign and by the Resolution become discharged from the trusts created by the Resolution, by notice in writing to be given to the Department and mailed, first class postage prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Trustee, not less than sixty (60) days before such resignation is to take effect, but such resignation shall take effect immediately upon the appointment of a new co-Trustee under the Resolution, if such new Trustee or co-Trustee shall be appointed before the time limited by such notice and shall then accept the trusts of the Resolution.

Removal of Co-Trustee (Section 813)

Subject to Section 811 of the Resolution, the co-Trustee may be removed at any time by an instrument or concurrent instruments in writing executed by the Department without the consent of Bondowners or by the owners of not less than a majority in principal amount of the Bonds secured by the Resolution and then Outstanding and filed with the Department. A facsimile copy of each such instrument shall be delivered promptly by the Department to the co-Trustee. The co-Trustee may also be removed at any time for reasonable cause by any court of competent jurisdiction upon the application of the owners of not less than ten per centum (10%) in aggregate principal amount of the Bonds then Outstanding under the Resolution.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Appointment of Successor Co-Trustee (Section 814)

(a) If at any time the co-Trustee shall resign, be removed, be dissolved or otherwise become incapable of acting, or the bank or trust company acting as co-Trustee shall be taken over by any governmental official, agency, department or board, the position of co-Trustee shall thereupon become vacant. If the position of co-Trustee shall become vacant for any of the foregoing reasons or for any other reason, the Department shall cause notice of such appointment to be mailed, first class postage prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Bond Registrar(s).

(b) At any time within one year after any such vacancy shall have occurred, the owners of a majority in principal amount of the Bonds secured by the Resolution and then Outstanding, by an instrument or concurrent instruments in writing, executed by such Bondowners and filed with the Department, may appoint a successor co-Trustee, which shall supersede any co-Trustee theretofore appointed by the Department. Facsimile copies of each such instrument shall be delivered promptly by the Department to the predecessor co-Trustee and to the co-Trustee so appointed by the Bondowners.

(c) If no appointment of a successor co-Trustee shall be made pursuant to the provisions of Section 813 of the Resolution within ten (10) days after the vacancy shall have occurred, the owner of any Bond Outstanding under the Resolution or any retiring co-Trustee may

apply to any court of competent jurisdiction to appoint a successor co-Trustee. Such court may thereupon, after such notice, if any, as such court may deem proper and prescribed, appoint a successor co-Trustee.

(d) Any co-Trustee hereafter appointed shall be a bank or trust company duly qualified to do business in the State, duly authorized to exercise corporate trust powers and subject to examination by Federal or State authority, of good standing, and having at the time of its appointment a combined capital and surplus aggregating not less than Fifty Million Dollars (\$50,000,000) as shown on its most recently published report of its financial condition.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

No Implied Duty; Standard of Care (Section 816)

The Trustee or co-Trustee shall have no duty or obligation *except* as expressly provided in the Resolution and no implied duties or obligations shall be read into the Resolution against the Trustee or co-Trustee. The Trustee or co-Trustee shall not incur any liability for any act or omission in performing its duties under the Resolution, *except* in the case of its own negligence or willful misconduct.

Bondowners' Consent Not Required (Section 1001)

The Department may, from time to time and at any time, adopt such resolutions supplemental to the Resolution which are filed with the Trustee (which Supplemental Resolutions shall thereafter form a part of the Resolution):

- (a) to cure any ambiguity or defect or omission in the Resolution; or
- (b) to grant to or confer upon the Trustee for the benefit of the Bondowners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondowners or the Trustee; or
- (c) to include as pledged revenues or money under, and subject to the provisions of, the Resolution any additional revenues or money legally available therefor; or
- (d) to make any other provisions with respect to matters or questions arising under the Resolution which shall not be inconsistent with the provisions of the Resolution, provided such action shall not materially adversely affect the interests of the Bondowners; or
- (e) to add to the covenants and agreements of the Department in the Resolution other covenants and agreements thereafter to be observed by the Department or to surrender any right or power in the Resolution reserved to or conferred upon the Department; or

(f) to add provisions relating to Bonds with coupons appertaining thereto or Bonds issued with full book-entry delivery, if necessary, if the Department shall determine to so issue Bonds in such form under the Resolution; or

(g) to modify any of the provisions of the Resolution in any respect whatever not otherwise set forth in the Section 1001 of the Resolution; *provided, however*, that either (i) such modification shall apply only to Series of Bonds issued after the effective date of the Supplemental Resolution and shall not materially adversely affect the interests of the owners of Bonds of any Series Outstanding on the effective date of the Supplemental Resolution or (ii) (a) such modification shall be, and be expressed to be, effective only after all Bonds of any Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding, and (b) such Supplemental Resolution shall be specifically referred to in the text of all Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Bonds issued in exchange therefor or in place thereof; or

(h) to modify, amend or supplement the Resolution or any Supplemental Resolution in such manner as to permit, if presented, the qualification of the Resolution and of the Supplemental Resolution under the Trust Indenture Act of 1939 or any similar Federal statute hereafter in effect or under any state Blue Sky Law; or

(i) to surrender any right, power or privilege reserved to or conferred upon the Department by the terms of the Resolution, provided that the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of the Department contained in the Resolution; or

(j) if the subject of a Rating Confirmation and if approved by the Trustee, to add to the definition of Investment Obligations pursuant to the last proviso of the definition thereof; or

(k) [reserved]

(l) accompanied by a Rating Confirmation, to make any amendment or supplement necessary to accommodate credit enhancement or liquidity support for any or all Series of Bonds; or

(m) to increase the amount of the combined Bond Reserve Requirement and Loan Loss Requirement to an amount greater than ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding Bonds; or

(n) to amend and supplement provisions of the Resolution regarding the Trustee, and the rights of the Department and the owners of Bonds with respect to appointment and replacement of the Trustee, in the event and to the extent the laws of the State are amended to allow an institution other than the State Treasurer to act as Trustee, provided, that any such institution shall meet the qualifications set forth in Section 814(d) of the Resolution as if such institution were acting as co-Trustee under the Resolution; or

(o) to make any other change which, in the judgment of the Trustee, does not materially adversely affect the interests of the Bondowners.

Supplements and Amendments Requiring Consent of Owners of a Majority in Principal Amount of Bonds (Section 1002)

Subject to the terms and provisions contained in Section 1002 of the Resolution, and not otherwise, (i) the owners of not less than fifty-one per centum (51%) in aggregate principal amount of the Bonds then Outstanding; and (ii) if less than all of the Bonds then Outstanding are affected, the owners of not less than fifty-one per centum (51%) in principal amount of Bonds so affected then Outstanding, shall have the right, from time to time, anything contained in the Resolution to the contrary *notwithstanding*, to consent to and approve the adoption by the Department and the Trustee of such resolution or resolutions supplemental to the Resolution as shall be deemed necessary or desirable by the Department for the purpose of modifying, altering, amending, adding to, repealing or rescinding, in any particular, any of the terms or provisions contained in the Resolution or in any Supplemental Resolution. Notwithstanding the foregoing, nothing in the Resolution contained shall permit, or be construed as permitting, without the consent of all materially adversely affected Bondowners, (a) any change in the terms of redemption or of the maturity of the principal of or the interest on any Bond issued under the Resolution, or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon, or (c) the creation of a lien upon or a pledge of the Pledged Property, or any part thereof, other than the lien and pledge created or permitted by the Resolution, or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, except as may be permitted by the applicable Series Resolution(s), or (e) a reduction in the aggregate principal amount or classes of the Bonds required for consent to such Supplemental Resolution, or (f) an amendment or modification of the rights or obligations of the Trustee without the written consent of the Trustee. Nothing in the Resolution contained, however, shall be construed as making necessary the approval by Bondowners of the execution of any Supplemental Resolution as authorized in Section 1001 of Article X of the Resolution. If any such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under Section 1002 of the Resolution. For the purpose of Section 1002 of the Resolution, a Series shall be deemed to be affected by a modification or amendment of the Resolution or a Supplemental Resolution if the same adversely affects or diminishes the rights of the owner of Bonds of such Series. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment, Bonds of any particular Series and maturity would be affected by any modification or amendment of the Resolution or a Supplemental Resolution and any such determination shall be binding and conclusive on the Department and all owners of Bonds.

Whenever, at any time within one year after the date of the first giving of such notice, the Department shall deliver to the Trustee an instrument or instruments in writing purporting to be executed by the owners of not less than fifty-one per centum (51%) in aggregate principal amount of the affected Bonds then Outstanding, which instrument or instruments shall refer to the proposed Supplemental Resolution described in such notice and shall specifically consent to and approve the execution thereof in substantially the form of the copy thereof referred to in such notice, thereupon, but not otherwise, the Trustee may perform its duties under such Supplemental Resolution in substantially such form, without liability or responsibility to any Bondowner, whether or not such Bondowner shall have consented thereto.

Under certain circumstances in which the Resolution requires approval or consent of the owners of all or a portion of the Bonds (including 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds) Outstanding under the Resolution, the Insurer will be deemed to be the owner of the 1998 Series A Bonds, the 2001 Series A Bonds, and the Offered Revenue Bonds.

Defeasance (Section 1101)

If, when the Bonds secured by the Resolution shall have become due and payable in accordance with their terms or otherwise as provided in the Resolution, or shall have been duly called for redemption or irrevocable instructions to call the Bonds for redemption shall have been given by the Department to the Trustee and (a) the whole amount of the principal of, Redemption Price, and the interest on all of such Bonds shall be paid, or (b) the Trustee shall hold money or Government Obligations or shall hold money and Government Obligations, sufficient to pay the principal of, Redemption Price, and interest on all Outstanding Bonds on their respective interest payment, stated maturity or prescribed redemption dates, provided that such Government Obligations shall be in such amount that the principal of and the interest on such Government Obligations so held by the Trustee, when due and payable, will provide sufficient money which, with any and all other money held by the Trustee for such purpose under the provisions of the Resolution, shall be sufficient to pay such principal of, Redemption Price, and the interest on such Bonds and, if sufficient funds shall also have been provided for paying all other obligations payable under the Resolution by the Department, then and in that case the right, title and interest of the Trustee under the Resolution shall thereupon cease, terminate and become void, and the Trustee in such case, on demand of the Department, shall release the Resolution and shall release the security, and shall execute such documents to evidence such release as may be reasonably required by the Department, and shall turn over to the Department or to such officer, board, or body as may then be entitled to receive the same, all the remaining property held by the Trustee under the Resolution. Otherwise, the Resolution shall be, continue and remain in full force and effect; provided, *however*, that in the event money or Government Obligations shall be deposited with and held by the Trustee as provided in the Resolution, applicable provisions of the Resolution, particularly Articles II, III, VII and XI, pertaining to the payment of the principal and Redemption Price of, or interest on the Bonds issued under the Resolution and other obligations payable under the Resolution by the Department, shall be continued in force until such Bonds and other obligations have been fully paid.

TAX MATTERS

Federal Tax Matters

The Offered Revenue Bonds are considered a single issue for Federal income tax purposes with the Winter 2001 Veterans G.O. Bonds. The requirements of applicable Federal tax law must be satisfied with respect to each series of the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds in order that interest on the Offered Revenue Bonds not be included in gross income for Federal income tax purposes retroactive to the date of issuance thereof. The Winter 2001 Veterans G.O. Bonds are qualified veterans mortgage bonds. The Offered Revenue Bonds are treated for Federal income tax purposes as refunding certain existing pre-Ullman bonds issued to finance the Program. The moneys which will be made available from the issuance of the Offered Revenue Bonds to finance Contracts of Purchase will be Unrestricted Moneys, and the

moneys which will be made available from the issuance of the Winter 2001 Veterans G.O. Bonds to finance new Contracts of Purchase will be Qualified Veterans Mortgage Bond Proceeds. The loan eligibility requirements described in APPENDIX G - "CERTAIN FEDERAL TAX CODE REQUIREMENTS" do not apply to Unrestricted Moneys, although certain of the restrictions apply to qualified veterans' mortgage bonds. These requirements also do not apply to the Contracts of Purchase to be allocated to the Offered Revenue Bonds for Federal income tax purposes following payment of the bonds being refunded by the Offered Revenue Bonds. The Federal Tax Code establishes other requirements described below which will apply to the Offered Revenue Bonds. Proceeds of the Offered Revenue Bonds and Winter 2001 Veterans G.O. Bonds must be used to retire outstanding bonds within ninety days of their respective dates of issuance. Failure to so use all of such proceeds and to comply with other requirements of the Federal Tax Code with respect to the Offered Revenue Bonds and the Winter 2001 Veterans G.O. Bonds could cause interest on the Offered Revenue Bonds to be included in gross income for Federal income tax purposes retroactive to their date of issuance.

Requirements Imposed on the Offered Revenue Bonds and Winter 2001 Veterans G.O. Bonds by the Federal Tax Code

The first general requirement of the Federal Tax Code applicable to the Offered Revenue Bonds is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. The Offered Revenue Bonds are within the applicable limit for the Department.

The Federal Tax Code requires that the effective interest rate on Contracts of Purchase financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds (such as the Winter 2001 Veterans G.O. Bonds) may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds such as the Offered Revenue Bonds) (see "Yield Limitations and Rebate" in APPENDIX G), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS - The 1943 Fund" and "THE PROGRAM - Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

The Federal Tax Code states that an issuer will be treated as meeting the arbitrage restrictions on mortgage loans if it in good faith attempted to meet such requirement and any failure to meet such requirement was due to inadvertent error after taking all reasonable steps to comply with such requirement.

The Department has covenanted in the Resolution to do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid on the Offered Revenue Bonds shall not be included in gross income for Federal income tax purposes.

Opinion of Bond Counsel

In the opinion of Hawkins, Delafield & Wood, Bond Counsel to the Department, under existing statutes and court decisions and assuming continuing compliance by the Department with certain tax covenants described herein, (i) interest on the Offered Revenue Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) interest on the Offered Revenue Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Department in connection with the Offered Revenue Bonds, and Bond Counsel has assumed compliance by the Department with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Offered Revenue Bonds from gross income under Section 103 of the Code.

Bond Counsel expresses no opinion regarding any other Federal or, except as stated below under "State Tax Matters," state tax consequences with respect to the Offered Revenue Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action taken after the date of issuance of the Offered Revenue Bonds, or not taken, in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Revenue Bonds, or under state and local tax law.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Offered Revenue Bonds under existing statutes. It does not purport to deal with all aspects of Federal taxation that may be relevant to a particular owner of an Offered Revenue Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Revenue Bonds.

As noted above, interest on the Offered Revenue Bonds is not a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Code. Interest on the Offered Revenue Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Prospective owners of the Offered Revenue Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes.

Interest on the Offered Revenue Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Legislation affecting municipal bonds is frequently considered by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Revenue Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Revenue Bonds.

State Tax Matters

Bond Counsel is of the opinion that, under existing law, the interest on the Offered Revenue Bonds is exempt from personal income taxes of the State. A complete copy of the proposed form of opinion to be rendered with respect to the Offered Revenue Bonds is contained in Appendix E.

LITIGATION

No Material Litigation

At the time of the delivery of and payment for the Offered Revenue Bonds, the Department shall deliver, or cause to be delivered (1) a certificate of the Attorney General of the State to the effect that, to his knowledge, no material litigation is pending (with service of process having been accomplished) or, to his knowledge, threatened in any court to restrain or enjoin the issuance or delivery of any of the Offered Revenue Bonds or the collection of Revenues or in any way contesting or affecting any authorization for, or the validity of, the Offered Revenue Bonds or the Resolution; and that, with respect to the officers who executed the Offered Revenue Bonds on behalf of the Department, to the best of his knowledge, the title of said officers to their respective offices is not being contested or questioned, and (2) an opinion of Chief Counsel to the Department to the effect that, other than as described in the following paragraphs, there is no action, suit or proceeding pending or, to his knowledge, threatened against the Department involving any of the property or assets of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account that involves the possibility of any judgment or uninsured liability which may result in any material adverse change in the business, properties or assets or in the condition, financial or otherwise, of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account; and that, with respect to the officers who executed the Offered Revenue Bonds on behalf of the Department, to the best of his knowledge, the title of said officers to their respective offices is not being contested or questioned.

Debbs Litigation

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department canceled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, an amount exceeding \$100 million in insurance reserves, which was returned to the Department,

thereafter was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, a determination that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Plaintiffs failed in their attempts to obtain a preliminary injunction and temporary restraining order, seeking to stop the Department from foreclosing Contracts of Purchase of veterans who have disability claims under the Department's current disability insurance program. Plaintiffs are appealing the denial of the preliminary injunction. The case was certified as a class action, but in December 2000, the court decertified the class for failure to notify the class members. That decertification decision has also been appealed. The appeals of the denial of the preliminary injunction and the decertification of the class are proceeding, though no date has been set for oral argument. The case as to the original named plaintiffs is stayed pending resolution of these appeals, though informal discovery has been permitted, and a status conference has been scheduled for March 20, 2002.

The Department is vigorously opposing the lawsuit. While the outcome of any litigation cannot be predicted with certainty, the Department expects ultimately to prevail in this matter. Even if the Plaintiffs should prevail in this matter, the Department does not expect such an outcome to affect timely payment of debt service on the Veterans G.O. Bonds or the Offered Revenue Bonds.

Jarvis Litigation

On June 24, 1998, plaintiffs in *Howard Jarvis Taxpayers Association et al. v. Connell* filed a complaint for certain declaratory and injunctive relief challenging the authority of the State Controller to make payments from the State Treasury in the absence of a state budget. The lawsuit did not specifically address the Department, the 1943 Fund or the continuing appropriations in the Veterans Code of funds to pay principal and interest on the Revenue Bonds. On July 21, 1998, the trial court issued a preliminary injunction prohibiting the State Controller from paying moneys from the State Treasury for fiscal year 1998-99, with certain limited exceptions, in the absence of a state budget. The preliminary injunction, among other things, prohibited the State Controller from making any payments pursuant to any continuing appropriation. On July 22 and 27, 1998, various employee unions which had intervened in the case appealed the trial court's preliminary injunction and asked the Court of Appeal to stay the preliminary injunction. On July 28, 1998, the Court of Appeal granted the unions' requests and stayed the preliminary injunction pending the Court of Appeal's decision on the merits of the appeal. On August 5, 1998, the Court of Appeal denied the plaintiffs' request to reconsider the stay. Also on July 22, 1998, the State Controller asked the California Supreme Court to immediately stay the trial court's preliminary injunction and to overrule the order granting the preliminary injunction on the merits. On July 29, 1998, the Supreme Court transferred the State Controller's request to the Court of Appeal. The matters are now pending before the Court of Appeal. Briefs have been submitted; no date has yet been set for oral argument.

The Attorney General and Bond Counsel, will render opinions, subject to the conditions and limitations set forth therein, that the conclusion of the Superior Court judge in the *Jarvis* case (which is now stayed pending appeal) questioning the validity of continuing appropriations, if and to the extent it would apply to the payment of debt service on the Offered Revenue Bonds, is without merit and that the California appellate courts would hold that the appropriations for debt service on the Offered Revenue Bonds contained in the Veterans Code are valid under the

California Constitution and that the Controller may make payments pursuant to such appropriations. While there can be no assurance as to the outcome of litigation, the Department believes moneys will be available in due course on a timely basis to make all future payments of debt service.

DELAYED DELIVERY OF THE OFFERED REVENUE BONDS

The Offered Revenue Bonds are to be delivered on or about March 6, 2002 (the "Settlement Date"). As with any issuance of bonds, events may occur during the period from the date of this Official Statement to the Settlement Date that affect the Department, the State, the Revenue Bonds, and the Veterans G.O. Bonds.

The Department and the State Treasurer have been informed by the Underwriters listed on the cover page (the "Underwriters") that the initial purchasers of the Offered Revenue Bonds will be required by the Underwriters to execute a delayed delivery contract (the "Delayed Delivery Contract"). Pursuant to the Delayed Delivery Contract, initial purchasers will be obligated to pay for and accept the Offered Revenue Bonds subject only to (a) the delivery of an opinion of Bond Counsel substantially in the form set forth in Appendix E to this Official Statement and (b) the delivery of the Offered Revenue Bonds. Such obligation is not subject to any other condition, including the ratings of the Offered Revenue Bonds (see "RATINGS" herein), an adverse change in the market price or marketability of the Offered Revenue Bonds, or any adverse change in the business, affairs, or financial condition of the State of California or the Department. In the event that any or all of the Offered Revenue Bonds are additionally secured by a bond insurance policy, the initial purchasers' obligation to pay for and accept such insured Offered Revenue Bonds will also be subject to issuance of the applicable bond insurance policy.

With respect to the Offered Revenue Bonds, the Department and the State Treasurer have entered into a bond purchase contract (the "Purchase Contract") with the Underwriters listed on the cover page. The Department and the State Treasurer are not parties to the Delayed Delivery Contracts and the respective obligations of the Department, the State Treasurer, and the Underwriters under the Purchase Contract are not conditioned or dependent upon performance of an initial purchaser under any Delayed Delivery Contract. Copies of the form of the Delayed Delivery Contract may be obtained from Bear, Stearns & Co. Inc., 10th Floor, 245 Park Avenue, New York, New York 10167, Attention: Municipal Bond Department, Telephone: 212-272-4910.

UNDERWRITING

The Offered Revenue Bonds are being purchased by the Underwriters. The Underwriters have jointly and severally agreed to purchase the Offered Revenue Bonds for a purchase price of the aggregate principal amount thereof. In connection therewith the Department will pay a fee to the Underwriters of \$937,298.81. The initial public offering prices of the Offered Revenue Bonds may be changed from time to time by the Underwriters.

The Purchase Contract relating to the Offered Revenue Bonds provides that (i) the Underwriters will purchase all of the Offered Revenue Bonds if any of the Offered Revenue Bonds are purchased, and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance, sale and delivery of the Offered Revenue Bonds to the Underwriters are subject to the approval of The Honorable Bill Lockyer, Attorney General of the State, and of Hawkins, Delafield & Wood, Bond Counsel to the Department. The issuance and acceptance of the Offered Revenue Bonds are conditioned upon delivery by Bond Counsel of the applicable approving opinion in substantially the applicable form set forth in APPENDIX E hereto and by the Attorney General of the applicable approving opinion in substantially the applicable form set forth in APPENDIX F hereto. Certain legal matters will be passed upon by Quateman & Zidell LLP, Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

FINANCIAL STATEMENTS

The financial statements of the 1943 Fund and the Veterans Debenture Revenue Fund as of June 30, 2001 and June 30, 2000 and for the years then ended, have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their reports appearing therein. See APPENDICES A and B.

LEGALITY FOR INVESTMENT

The Act provides that the Offered Revenue Bonds shall be legal investments in California for all trust funds, funds of all insurance companies, banks (both commercial and savings), trust companies, state school funds, and pension funds, public or private. The Act also provides that any money or funds which may by law be invested in bonds of the State may be invested in the Offered Revenue Bonds and that whenever any bonds of the State may by law be used as security for the performance of any act or the deposit of any public money, the Offered Revenue Bonds may be so used.

RATINGS

The Offered Revenue Bonds are expected to receive ratings of "Aaa" by Moody's, "AAA" by S&P, and "AAA" by Fitch. Such ratings will be based upon the issuance of the Financial Guaranty Insurance Policy. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies, if in their respective judgments, circumstances so warrant. A revision or withdrawal of any such credit rating could have an effect on the market price of the Offered Revenue Bonds.

CONTINUING DISCLOSURE

The Department has covenanted in a Master Continuing Disclosure Undertaking (the "Master Continuing Disclosure Undertaking"), for the benefit of the Holders and Beneficial Owners (each as defined in APPENDIX C) of the Offered Revenue Bonds, to provide certain financial information and operating data relating to the Department (the "Annual Financial Information") by not later than the first day of the tenth calendar month following the end of the

Department's then-current fiscal reporting period, commencing with the reporting period ended June 30, 1997, and to provide notices of the occurrence of certain enumerated events, if material. The Master Continuing Disclosure Undertaking requires that the Annual Financial Information be filed by the Department with the Trustee, with the State information depository (the "SID"), if any, and with each nationally recognized municipal securities information repository (each, a "NRMSIR"). The Master Continuing Disclosure Undertaking requires that notices of material events be filed by the Department with the Trustee, with the SID and with either of each NRMSIR or the Municipal Securities Rulemaking Board. The specific nature of the information to be contained in the Annual Financial Information or the notices of material events is summarized in APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE MASTER CONTINUING DISCLOSURE UNDERTAKING." These covenants have been made in order to assist the Underwriters in complying with Rule 15c2-12(b)(5) promulgated by the Securities and Exchange Commission (the "Rule"). The Department has never failed to comply in all material respects with any previous undertakings with respect to the Rule to provide annual financial information or notices of material events.

MISCELLANEOUS

The information set forth herein is subject to change without notice and no implication should be derived therefrom or from the sale of the Offered Revenue Bonds that there has been no change in the affairs of the Department after the date hereof. The distribution of this Official Statement has been duly authorized by the Department. Any statement in this Official Statement involving matters of opinion, whether or not expressly so stated, is intended as such, and not as a representation of fact. Concurrently with the delivery of the Offered Revenue Bonds, the Department will furnish a certificate to the effect that this Official Statement, as of its date and as of the date of delivery of the Offered Revenue Bonds, does not and will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements herein, in the light of the circumstances under which they were made, not misleading. The agreement of the Department with the holders of the Offered Revenue Bonds is set forth in the Resolution. This Official Statement is not to be construed as an agreement or contract between the Department and the purchaser or holder of any of the Offered Revenue Bonds. Additional information may be obtained from the Department at 1227 "O" Street, Sacramento, California 95814, Attention: Bond Finance Division.

DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA

By: /s/ Bruce Thiesen
Secretary

Dated: November 29, 2001

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APPENDIX A

**FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2001
AND 2000 AND INDEPENDENT AUDITOR'S REPORT**

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**VETERANS FARM AND HOME
BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS
AFFAIRS, STATE OF CALIFORNIA**

**Financial Statements for the Years Ended June 30,
2001 and 2000 and Independent Auditors' Report**

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INDEPENDENT AUDITORS' REPORT

To the California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943 ("the Fund"), which is administered by the Department of Veterans Affairs of the State of California ("the Department") as of June 30, 2001 and 2000, and the related statements of revenues, expenses and changes in retained earnings, and of cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, of the Department of Veterans Affairs of the State of California as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

October 27, 2001

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS

JUNE 30, 2001 AND 2000 (in thousands)

	2001	2000
ASSETS		
CASH IN STATE TREASURY	\$ 20,393	
INVESTMENTS:		
Unrestricted	327,442	\$ 279,662
Restricted	295,799	620,901
Insurance administrators	<u>18,139</u>	<u>24,860</u>
Total investments	641,380	925,423
RECEIVABLES UNDER CONTRACTS OF SALE, Net of allowance for uncollectible contracts of \$16,715 in 2001 and \$19,676 in 2000	2,588,344	2,398,616
DUE FROM VETERANS DEBENTURE REVENUE FUND	40,905	33,847
INTEREST RECEIVABLE:		
Contracts of sale	18,615	15,455
State of California's Surplus Money Investment Fund	3,301	3,528
Other investments	1,607	4,968
DUE FROM OTHER FUNDS	6,810	6,952
OTHER REAL ESTATE OWNED, Net of allowance for losses of \$2,592 in 2001 and \$3,050 in 2000	15,590	13,714
LAND, IMPROVEMENTS AND EQUIPMENT, Net of accumulated depreciation of \$9,260 in 2001 and \$8,080 in 2000	6,273	7,288
OTHER	<u>819</u>	<u>933</u>
TOTAL ASSETS	<u><u>\$3,344,037</u></u>	<u><u>\$3,410,724</u></u>
LIABILITIES AND RETAINED EARNINGS		
LIABILITIES:		
Cash overdraft due to State Treasury		\$ 17,340
Accrued interest and other liabilities	\$ 61,687	71,785
Due to other funds	170	
Bonds payable - net	2,960,468	3,009,111
Insurance claims payable and loss reserves	<u>33,666</u>	<u>39,051</u>
Total liabilities	3,055,991	3,137,287
RETAINED EARNINGS	<u>288,046</u>	<u>273,437</u>
TOTAL LIABILITIES AND RETAINED EARNINGS	<u><u>\$3,344,037</u></u>	<u><u>\$3,410,724</u></u>

See notes to financial statements.

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
YEARS ENDED JUNE 30, 2001 AND 2000 (in thousands)**

	2001	2000
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of sale of properties	\$ 179,755	\$ 150,213
Investments and other	42,748	71,607
Transfers of revenue from Veterans Debenture Revenue Fund	<u>2,219</u>	<u>1,476</u>
Total program operations revenues	<u>224,722</u>	<u>223,296</u>
Expenses:		
Interest expense	188,017	193,495
Reversal of allowance for uncollectible contracts	<u>(3,420)</u>	<u>(6,641)</u>
Total program operations expenses	<u>184,597</u>	<u>186,854</u>
Excess of program operations revenues over program operations expenses	<u>40,125</u>	<u>36,442</u>
PROGRAM ADMINISTRATION:		
Revenues:		
Loan fees	7,190	4,784
Other income	938	995
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	<u>2,786</u>	<u>1,408</u>
Total program administration revenues	<u>10,914</u>	<u>7,187</u>
Expenses:		
Payroll and related costs	12,682	12,241
General and administrative expenses	20,159	20,076
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	<u>3,644</u>	<u>4,761</u>
Total program administration expenses	<u>36,485</u>	<u>37,078</u>
Excess of program administration expenses over program administration revenues	<u>(25,571)</u>	<u>(29,891)</u>
GAIN (LOSS) ON SALE OF REPOSSESSED PROPERTY	<u>55</u>	<u>(2,683)</u>
EXCESS OF REVENUES OVER EXPENSES	14,609	3,868
RETAINED EARNINGS:		
Beginning of year	<u>273,437</u>	<u>269,569</u>
End of year	<u>\$ 288,046</u>	<u>\$ 273,437</u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2001 AND 2000 (in thousands)

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenues over expenses	\$ 14,609	\$ 3,868
Adjustments to reconcile to net cash used by operating activities:		
Amortization of bond premiums, discounts and issuance costs	4,674	1,855
Reversal of allowance for uncollectible contracts	(3,420)	(6,641)
Depreciation	1,180	1,094
Loss on sale of repossessed property	(55)	2,683
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus Money Investment Fund	227	470
Interest receivable - other investments	3,361	3,246
Interest receivable - contracts of sale	(3,160)	(4,944)
Due from other funds	142	(829)
Other real estate owned	(1,821)	4,168
Other assets	114	(467)
Accrued interest and other liabilities	(10,098)	21,809
Due to other funds	170	
Insurance claims payable and loss reserves	(5,385)	(4,102)
Net cash provided by operating activities	<u>538</u>	<u>22,210</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase in receivables under contracts of sale	(186,308)	(383,162)
Net decrease in investment securities	284,043	421,316
Purchase of land, improvements and equipment	(165)	(804)
Net cash provided by investing activities	<u>97,570</u>	<u>37,350</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Increase (decrease) in cash overdraft due to State Treasury	(17,340)	10,947
Proceeds from sales of bonds	538,026	243,700
Maturities of bonds payable	(90,975)	(162,991)
Early redemption of bonds payable	(494,660)	(139,840)
Net decrease in Due from Veterans Debenture Revenue Fund	(7,058)	(11,376)
Additions to deferred financing costs	(5,708)	
Net cash used by noncapital financing activities	<u>(77,715)</u>	<u>(59,560)</u>
INCREASE IN CASH IN STATE TREASURY	20,393	-
CASH IN STATE TREASURY:		
Beginning of year	<u>-</u>	<u>-</u>
End of year	<u><u>\$ 20,393</u></u>	<u><u>\$ -</u></u>

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2001 AND 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Funds Accounting*, established standards for accounting and financial reporting for proprietary funds. In accordance with GASB No. 20, the Fund's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as the following pronouncements issued on, or before, November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedures.

Investments - The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of

investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments.

Receivables Under Contracts of Sale - Receivables under contracts of sale consist of the remaining contract principal balance net of the reserve for uncollectible accounts.

Allowance for Uncollectible Contracts - The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Contract Guarantees and Primary Mortgage Insurance - During 1998, the Department started collecting a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance (PMI) from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported claims and loss reserves for the fire and hazard insurance plan and the remaining benefits payable under the Department's former self-insured life and disability protection plan.

Fire and Hazard Insurance - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan - Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 1997. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

Amortization of Bond Premiums, Discounts and Issuance Costs - Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

New Accounting Pronouncements – In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards (SGAS) No. 34, *Basis Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The statement establishes financial reporting standards for certain governmental entities which will require expanded financial information, management discussion and analysis and certain supplemental information. This statement will be effective for the Department for the year ended June 30, 2002. The Department is in the process of determining what effect adopting SGAS No. 34 will have on the Fund's financial statements.

Reclassification - Certain 2000 amounts have been reclassified to conform with the 2001 presentation.

2. CASH AND INVESTMENTS

Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

The cash overdrafts of \$17,340,000 as of June 30, 2000 represented a liability due to the State Treasury.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law.

The Fund's investments in investment agreements totaling \$319,476,000 as of June 30, 2001 are carried at cost. The interest rates on investment agreements are fixed and range from 5.30% to 7.055%. The investment agreements expire from 2001 to 2032.

All of the Fund's investments in U.S. Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized as to risk.

The Fund's investments at June 30, 2001 and 2000 are as follows (in thousands):

	2001	2000
Category 1		
U.S. Treasury notes and bonds		\$ 112,107
Amounts held in trust fund with insurance administrators:		
U.S. Treasury notes	\$ 1,676	5,433
Corporate bonds	11,207	7,441
Other	3,950	10,452
Investments Not Subject to Categorization		
State of California's Surplus Money Investment Fund	303,765	226,076
Investment agreements (at cost)	319,476	562,380
Amounts held in trust fund with insurance administrators:		
Mutual fund (Vanguard)	<u>1,306</u>	<u>1,534</u>
Total	<u>\$ 641,380</u>	<u>\$ 925,423</u>

3. RECEIVABLES UNDER CONTRACTS OF SALE

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 9.75%, depending on the age and type of contract and the classification of the current contract holder. During 1998, the Department lowered the rate on most of the existing contracts of purchase from 8.0% to 6.95%.

4. BONDS PAYABLE

At June 30, 2001 and 2000, bonds payable included the following (in thousands):

	2001	2000
General obligation bonds of the State of California, annual interest rates from 3.6% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	\$2,415,765	\$2,528,330
Home purchase revenue bonds, annual interest rates from 4.05% to 6.15%, due in varying annual installments through 2028 (subject to varying redemption provisions)	<u>570,940</u>	<u>505,815</u>
Total	2,986,705	3,034,145
Discounts	(3,185)	(4,048)
Unamortized bond origination costs	(16,424)	(13,417)
Unamortized bond redemption premiums	<u>(6,628)</u>	<u>(7,569)</u>
Total	<u>\$2,960,468</u>	<u>\$3,009,111</u>

Future scheduled bond maturities at June 30, 2001 are as follows (in thousands):

2002	\$ 73,330
2003	76,010
2004	107,115
2005	120,705
2006	138,145
Thereafter	<u>2,471,400</u>
Total	<u>\$2,986,705</u>

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1996 and 2000 at June 30, 2001 and 2000 were \$605,585,000 and \$176,835,000, respectively.

Home Purchase Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the \$1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 2001 and 2000, authorized and unissued revenue bonds were \$929,060,000 and \$994,185,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds, and 2001 Series A Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2001 and 2000, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

5. BOND REFUNDING

During fiscal year 2001, the Department issued General Obligation bonds totaling \$358,625,000 and Home Purchase Revenue bonds totaling \$179,570,000 with an average interest rate of 5.37%. Bond proceeds from the General Obligation bond issues and proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of \$434,255,000 and Revenue bonds of \$103,940,000.

For those bonds that could not be called for immediate redemption, approximately \$10,895,000 is deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liability for those bonds is not included in the Fund's balance sheet.

The Department decreased its total debt service payments over the next 15 years by approximately \$189,400,000 and realized an economic gain (difference between the present values of the debt service payment on the old and new debt adjusted by additional cash paid) of approximately \$19,643,000 in connection with the refunding.

During the 2001 fiscal year, the escrow trustee retired approximately \$6,400,000 of bonds which were considered defeased as of June 30, 2000.

6. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to \$1,500,000 per occurrence or \$12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 2001 and 2000 was as follows (in thousands):

	2001	2000
Amounts charged to contract holders	\$ 9,772	\$ 8,768
(Less) plus:		
(Increase) decrease in estimated loss reserve	221	115
Claims loss expense	(6,186)	(6,475)
Master policy premium	(549)	(469)
Administrative fees	<u>(472)</u>	<u>(531)</u>
Excess of amounts charged to contract holders over claims and expenses and changes in reserves	<u>\$ 2,786</u>	<u>\$ 1,408</u>

7. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. At that time, except for contract holders receiving benefits, the self-insured life and disability protection plan was replaced by an interim life and disability insurance plan provided by a commercial insurer, Pacific Life Insurance (PLI). Effective February 1, 1998, PLI was selected to provide a replacement, long-term life and disability plan.

As of June 30, 2001, the Department remains self-insured for approximately 737 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were \$1,175,589 and \$1,350,145 in 2001 and 2000, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 2001 and 2000 was as follows (in thousands):

	2001	2000
Claims expenses:		
Life insurance program	\$ (133)	\$ (2,220)
Disability insurance program	<u>(8,371)</u>	<u>(10,456)</u>
Total claims expenses	(8,504)	(12,676)
Decrease in estimated loss reserves	<u>4,917</u>	<u>8,109</u>
Net claims expenses and change in loss reserves	(3,587)	(4,567)
Plus plan revenues:		
Life insurance program	91	94
Disability insurance program	<u>133</u>	<u>134</u>
Total	224	228
Less administrative fees	<u>(281)</u>	<u>(422)</u>
Excess (deficiency) of plan revenues over net claims expense	<u>\$ (3,644)</u>	<u>\$ (4,761)</u>

8. COMMITMENTS AND CONTINGENCIES

As of June 30, 2001 and 2000, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately \$30,255,000 and \$369,507,830, respectively.

The Department is a defendant in certain litigation related to the Department's former Self-Insured Life and Disability Protection Plan, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2001 and 2000 was \$415,271 and \$445,083, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 2001, minimum annual rentals under operating leases are as follows (in thousands):

2002	\$ 266,192
2003	184,413
2004	171,485
2005	68,089
Thereafter	<hr/>
Total	<u>\$ 690,179</u>

9. RETIREMENT PLAN

The Fund, through the Department and the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Department, whose compensation is paid from the Fund, are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P.O. Box 1802, Sacramento, CA 95812-1802.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$238 to \$863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

Contributions by the Department to the Plan for the years ended June 30, 2001 and 2000 were approximately \$116,000 and \$98,000, or approximately 3.8% and 5.6% of participants' salaries, respectively. Employee contributions to the Plan for the years ended June 30, 2001 and 2000 were approximately \$377,000 and \$378,000 or approximately 3.1% and 4.1% of participants' salaries, respectively.

For fiscal years ended June 30, 2001 and 2000, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1997 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 3.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is

being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1997 was 32 years. Three-year fund trend information is as follows:

Three-Year Fund Trend Information			
Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1999	\$ 625,000	100%	\$ -
June 30, 2000	\$ 98,000	100%	\$ -
June 30, 2001	\$ 116,000	100%	\$ -

The most recent actuarial valuation of CalPERS indicated that there was an unfunded liability for vested benefits due current employee participants in the plan. The amount of the unfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 1998 CalPERS CAFR.

Since all state agencies and departments are considered by CalPERS collectively as a single employer, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded liability, the actuarial value of assets as a percentage of the actuarial accrued liability, and the ratio of unfunded actuarial liability to annual covered payroll attributable to the Department's employees, whose compensation is paid from the Fund, cannot be determined.

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APPENDIX B

**FINANCIAL STATEMENTS OF THE VETERANS DEBENTURE REVENUE FUND
FOR FISCAL YEARS 2001 AND 2000 AND INDEPENDENT AUDITOR'S REPORT**

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**VETERANS DEBENTURE
REVENUE FUND, DEPARTMENT
OF VETERANS AFFAIRS, STATE
OF CALIFORNIA**

**Financial Statements for the Years Ended June 30,
2001 and 2000 and Independent Auditors' Report**

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INDEPENDENT AUDITORS' REPORT

To the California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Debenture Revenue Fund, Department of Veterans Affairs of the State of California (Fund) as of June 30, 2001 and 2000 and the related statements of revenues and expenses, and of cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Debenture Revenue Fund and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Debenture Revenue Fund, Department of Veterans Affairs of the State of California as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

October 27, 2001

**VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA**

**BALANCE SHEETS
JUNE 30, 2001 AND 2000**

	2001	2000
RESTRICTED ASSETS		
CASH IN STATE TREASURY	\$ 800	\$ 1,807
INVESTMENTS IN STATE OF CALIFORNIA'S SURPLUS MONEY INVESTMENT FUND (at fair value)	2,788,000	1,602,000
INVESTMENT AGREEMENTS (at cost)	30,988,500	25,255,500
INVESTMENTS IN U.S. TREASURY NOTES AND BONDS (at fair value)	6,885,478	6,783,505
INTEREST RECEIVABLE:		
State of California's Surplus Money Investment Fund	27,924	17,640
U.S. Treasury notes and bonds	52,918	52,918
Investment contracts	<u>160,973</u>	<u>133,257</u>
Total interest receivable	<u>241,815</u>	<u>203,815</u>
TOTAL RESTRICTED ASSETS	<u>\$40,904,593</u>	<u>\$33,846,627</u>
LIABILITIES		
INCOME FROM INVESTMENTS DUE TO THE VETERANS FARM AND HOME BUILDING FUND OF 1943	\$ 125,093	\$ 1,588,927
BOND RESERVE DUE TO THE VETERANS FARM AND HOME BUILDING FUND OF 1943	<u>40,779,500</u>	<u>32,257,700</u>
TOTAL LIABILITIES	<u>\$40,904,593</u>	<u>\$33,846,627</u>

See notes to financial statements.

**VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES AND EXPENSES
YEARS ENDED JUNE 30, 2001 AND 2000**

	2001	2000
REVENUES:		
Income from investments	\$2,218,802	\$1,475,753
OPERATING TRANSFERS OUT:		
Veterans Farm and Home Building Fund of 1943	<u>2,218,802</u>	<u>1,475,753</u>
EXCESS OF REVENUES OVER OPERATING TRANSFERS OUT	<u>\$ -</u>	<u>\$ -</u>

See notes to financial statements.

**VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA**

**STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2001 AND 2000**

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenues over operating transfers out	\$ -	\$ -
Adjustments to reconcile to net cash used by operating activities:		
Effect of changes in assets and liabilities:		
Interest receivable	(38,000)	124,765
Income from investments due to the Veterans Farm and Home Building Fund of 1943	(1,463,834)	1,189,853
Bond reserve due to the Veterans Farm and Home Building Fund of 1943	<u>8,521,800</u>	<u>10,186,000</u>
Net cash provided by operating activities	<u>7,019,966</u>	<u>11,500,618</u>
CASH FLOWS FROM INVESTING ACTIVITIES -		
Increase in investment securities	<u>(7,020,973)</u>	<u>(11,499,189)</u>
Net cash used by investing activities	<u>(7,020,973)</u>	<u>(11,499,189)</u>
NET INCREASE (DECREASE) IN CASH IN STATE TREASURY	(1,007)	1,429
CASH IN STATE TREASURY:		
Beginning of year	<u>1,807</u>	<u>378</u>
End of year	<u>\$ 800</u>	<u>\$ 1,807</u>

See notes to financial statements.

VETERANS DEBENTURE REVENUE FUND

DEPARTMENT OF VETERANS AFFAIRS,

STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2001 AND 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Fund - The California Department of Veterans Affairs (the Department) is a separate legal entity, acting as a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Department is authorized to issue revenue bonds to fund low-interest farm and home loan contracts with veterans living in California.

In December 1997, the Department amended the revenue bond resolution provision regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (Fund). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Veterans Farm and Home Building Fund of 1943 (Farm and Home Fund), at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Farm and Home Fund.

At June 30, 2001 and 2000, the liabilities of the Veterans Debenture Revenue Fund represent amounts due to the Farm and Home Fund and, accordingly, are included as a receivable in the financial statements of the Farm and Home Fund.

The financial statements represent only the activities of the Veterans Debenture Revenue Fund and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

New Accounting Pronouncements - In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards (SGAS) No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The statement establishes financial reporting standards for certain governmental entities which will require expanded financial information, management discussion and analysis and certain supplemental information. This statement will be effective for the Department for the year ended June 30, 2002. The Department is in

the process of determining what effect adopting SGAS No. 34 will have on the Fund's financial statements.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and become measurable, and expenses are recognized as incurred.

Cash and Investments - All investments are reported at fair value except for nonparticipating fixed interest investment agreements which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Income from investments includes net unrealized appreciation or depreciation in the fair value of investments.

Revenues and Operating Transfers - Income from investments are recorded as earned. A corresponding operating transfer out is recorded to reflect the required transfer to the Farm and Home Fund.

Restricted Assets - Assets are restricted for paying the principal, interest and mandatory sinking account payments on revenue bonds (if no other monies within the Farm and Home Fund are available) or retiring all revenue bonds then outstanding.

2. CASH AND INVESTMENTS

Cash in State Treasury of \$800 and \$1,807 as of June 30, 2001 and 2000 represents amounts held in the Fund's general operating account with the State Treasury. These monies are pooled with the monies of other state agencies and invested by the State Treasurer's office. These investments are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions rated within the top two ratings of a nationally recognized rating service.

The Fund's investment in four investment agreements of \$30,988,500 as of June 30, 2001 is carried at cost. All investment agreements are fixed rate contracts. The contracts mature in 2028 and bear interest from 5.38% to 6.90%.

All of the Fund's investments in U.S. Treasury notes and bonds are categorized as risk category 1, which is defined by the GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund and the investment agreements are not categorized as to risk.

* * * * *

APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE MASTER CONTINUING DISCLOSURE UNDERTAKING

Certain provisions of the Master Continuing Disclosure Undertaking of the Department not previously discussed in this Official Statement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Master Continuing Disclosure Undertaking.

The Master Continuing Disclosure Undertaking, dated December 29, 1997, was executed and delivered by the Department for the benefit of the Holders and the Beneficial Owners and in order to assist the Underwriters in complying with SEC Rule 15c2-12(b)(5). The Offered Revenue Bonds are Subject Bonds.

Certain Definitions

Defined terms used in the Master Continuing Disclosure Undertaking and not otherwise defined therein have the meanings set forth in the Resolution.

"Beneficial Owner" means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

"Bonds" means, at any time, all of the Department's then Outstanding Home Purchase Revenue Bonds, collectively.

"Fiscal Year" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements, as defined in the Master Continuing Disclosure Undertaking, are prepared. As of the date of the Master Continuing Disclosure Undertaking, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"Holders" means the registered owners of the Subject Bonds.

"Listed Event" means any of the events listed below under the heading "Reporting of Certain Events".

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934.

"Notice" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"Notice Address" means with respect to the Department:

State of California Department of Veterans Affairs 1227 "O" Street Sacramento, CA 95814
Attention: Bond Finance Division.

"NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"Official Statement" means the offering document of the Department dated December 10, 1997 with respect to the Department's Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C, and 1998 Series A.

"Rule" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Master Continuing Disclosure Underwriting including any official interpretations thereof.

"SEC" means the United States Securities and Exchange Commission.

"Securities Counsel" means legal counsel expert in Federal securities laws.

"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.

"Subject Bonds" means those Bonds with respect to which the terms of the Master Continuing Disclosure Undertaking are expressly incorporated into any one of the Department documents authorizing the issuance of such Bonds.

"Underwriters" means any of the original underwriters of any Subject Bonds required to comply with the Rule in connection with the offering of such Subject Bonds.

Provision of Annual Financial Information

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 1996-1997 Fiscal Year, provide to the Trustee and to each NRMSIR and the SID the Annual Financial Information. The Audited Financial Statements of the Department and of the Bond Reserve Account and Loan Loss Account may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Master Continuing Disclosure Undertaking requires the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the Trustee and to either (i) each NRMSIR or (ii) the MSRB.

Content of Annual Financial Information

The Department's Annual Financial Information shall contain or include by reference the following:

- (a) the audited financial statements of the 1943 Fund and of the Bond Reserve Account and Loan Loss Account for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year; and
- (b) financial information or operating data of the types included in APPENDIX D of the Official Statement entitled "Certain Department Financial Information and Operating Data."*

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the Trustee and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including fiscal statements of debt issues of the Department or related public entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Reporting of Certain Events

The Department will give notice to the Trustee and to the SID and to either each NRMSIR or the MSRB of the occurrence of any of the following events with respect to the Subject Bonds, if material:

As of the date of this Official Statement, there is no SID.

- (1) principal and interest payment delinquencies;
- (2) non-payment related defaults;
- (3) modification to rights of Holders;
- (4) Subject Bond calls;
- (5) unscheduled draws on credit enhancements reflecting financial difficulties;
- (6) substitution of credit or liquidity providers, or their failure to perform;

* Such information or data is substantially similar to that included in Appendix D of this Official Statement.

- (7) defeasances;
- (8) rating changes;
- (9) adverse tax opinions or events affecting the tax-exempt status (if applicable) of any Subject Bonds;
- (10) unscheduled draws on the debt service reserves reflecting financial difficulties; or
- (11) release, substitution or sale of property securing repayment of the Subject Bonds.

Additional Information

Nothing in the Master Continuing Disclosure Undertaking shall be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in the Master Continuing Disclosure Undertaking or any other means of communication, or including any other information in any Annual Financial Information or notice of occurrence of a Listed Event, in addition to that which is required by the Master Continuing Disclosure Undertaking. If the Department chooses to include any information in any Annual Financial Information or notice of occurrence of a Listed Event in addition to that which is specifically required by the Master Continuing Disclosure Undertaking, the Department shall have no obligation under the Master Continuing Disclosure Undertaking to update such information or include it in any future Annual Financial Information or notice of occurrence of a Listed Event.

Amendment of Master Continuing Disclosure Undertaking

The Master Continuing Disclosure Undertaking may be amended and any provision of the Master Continuing Disclosure Undertaking may be waived, without the consent of the Holders or Beneficial Owners, except as described in clause 4(ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature, or status of the Department or the type of business conducted thereby, (2) the Master Continuing Disclosure Undertaking as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have delivered to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as the Trustee or bond counsel), acceptable to the Trustee and the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the Holders consent to the amendment or waiver of the Master Continuing Disclosure Undertaking pursuant to the same procedures as are required for amendments to the Resolution with consent of Holders, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the Trustee, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Master Continuing Disclosure Undertaking, and any provision of the Master Continuing Disclosure Undertaking may be waived, if the Trustee shall have received an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that the adoption and the terms of such amendment or waiver would not, in and of themselves, cause the undertakings in the Master Continuing Disclosure Undertaking to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Benefit; Enforcement

The provisions of the Master Continuing Disclosure Undertaking shall inure solely to the benefit of the Holders and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Master Continuing Disclosure Undertaking will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Master Continuing Disclosure Undertaking shall be enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of Outstanding Subject Bonds, or by the Trustee on behalf of the Holders of Outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Trustee on behalf of the Holders of Outstanding Subject Bonds or by any Beneficial Owner; provided, however, that a Beneficial Owner may not take any enforcement action pursuant to clause (ii) without the consent of the Holders of not less than 20% in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Master Continuing Disclosure Undertaking shall be limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Master Continuing Disclosure Undertaking. Any failure by the Department to perform in accordance with the Master Continuing Disclosure Undertaking will not constitute a default or an Event of Default under the Resolution, and the rights and remedies provided by the Resolution upon the occurrence of a default or an Event of Default will not apply to any such failure.

Termination of Reporting Obligation

The Department's obligations under the Master Continuing Disclosure Undertaking with respect to the Subject Bonds shall terminate upon the legal defeasance under the Resolution, prior redemption, or payment in full of all of the Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Master Continuing Disclosure Undertaking, or any provision thereof, will be null and void to the extent set forth in the opinion of Securities Counsel described in clause (1) in the event that the Department (1) delivers to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that those portions of the Rule which require the

provisions of the Master Continuing Disclosure Undertaking, or any of such provisions, do not or no longer apply to the Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion, and (2) delivers notice to such effect to the Trustee, to the SID and to either each NRMSIR or the MSRB.

Governing Law

The Master Continuing Disclosure Undertaking will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Master Continuing Disclosure Undertaking will be instituted in a court of competent jurisdiction in the State, provided that, to the extent the Master Continuing Disclosure Undertaking addresses matters of Federal securities laws, including the Rule, the Master Continuing Disclosure Undertaking will be construed in accordance with such Federal securities laws and official interpretations thereof.

APPENDIX D

CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of September 30, 2001 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund.

Current Loan-to-Value Ratio of Contracts of Purchase⁽¹⁾⁽²⁾

	<u>Uninsured</u>	<u>Radian Insured⁽⁵⁾</u>	<u>Radian Insured⁽⁶⁾</u>	<u>In Process for Radian Insurance</u>	<u>VA Guaranteed</u>	<u>Total</u>
Single Family Homes						
Less than 30% LTV	\$ 107,227	\$ 116	\$ 30	--	\$ 120	\$ 107,493
30-49% LTV	247,584	748	72	--	350	248,754
50-59% LTV	166,047	1,154	--	--	178	167,379
60-69% LTV	202,964	6,510	145	--	556	210,175
70-79% LTV	220,082	81,978	321	--	2,646	305,027
Sub-total	\$ 943,904	\$ 90,506	\$ 568	--	\$ 3,850	\$ 1,038,828
80-84% LTV	\$ 21,452	\$ 148,409	\$ 18,129	--	\$ 9,081	\$ 197,071
85-89% LTV	28,319	248,612	56,850	\$ 1,864	26,594	362,239
90-94% LTV	45,380	94,815	118,553	6,042	80,081	344,871
95-97% LTV	34,273	797	134,989	12,343	77,049	259,451
Sub-total	\$ 129,424	\$ 492,633	\$ 328,521	\$ 20,249	\$ 192,805	\$ 1,163,632
Greater than 97% LTV	\$ 35,132	\$ 1,388	\$ 112,799	\$ 369	\$ 157,437	\$ 307,125
Other Property Types						
Farms	\$ 5,552	\$ 199	--	--	--	\$ 5,751
Mobile Homes in Parks	8,303	--	\$ 192	--	--	8,495
Sub-total	\$ 13,855	\$ 199	\$ 192	--	--	\$ 14,246
Special Status Contracts of Purchase						
Real Estate Owned ⁽³⁾	\$ 9,852	\$ 3,616	\$ 569	--	\$ 139	\$ 14,176
Disability Program ⁽⁴⁾	21,763	--	1,518	--	--	23,281
Sub-total	\$ 31,615	\$ 3,616	\$ 2,087	--	\$ 139	\$ 37,457
Total Portfolio	\$ 1,153,930	\$ 588,342	\$ 444,167	\$ 20,618	\$ 354,231	\$ 2,561,288

(1) 000's omitted

(2) LTV based on current Contracts of Purchase balance divided by original appraised value of the property, except that the Department updates the appraised value of the home when the veteran applies for a home improvement loan. In such cases, the LTV is calculated with the new appraised value.

(3) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.

(4) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.

(5) The policy was executed on February 28, 1998.

(6) The policy was executed on July 1, 2000.

Geographic Distribution of Contracts of Purchase

County	Approximate Current Contract Balance
San Diego	\$ 289,828,868
Sacramento	264,678,476
Los Angeles	184,465,545
San Bernardino	169,179,797
Riverside	161,879,421
Fresno	115,360,490
Orange	114,979,902
Kern	101,449,614
Solano	96,820,765
Placer	88,909,092
San Joaquin	74,720,807
Shasta	64,315,791
Contra Costa	60,448,103
Other Northern California Counties	402,508,887
Other Central California Counties	270,621,414
Other Southern California Counties	101,121,058
Statewide--California	<u>\$ 2,561,288,030</u>

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985 fiscal year.

New Contracts of Purchase During the Fiscal Year⁽¹⁾

Fiscal Year Ending June 30	Veterans G.O. Bonds		Unrestricted Funds		Revenue Bonds		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
1985	4,196	\$ 290,885,900			2,301	\$ 154,244,600	6,497	\$ 445,130,500
1986	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993	740	94,417,100			286	27,443,800	1,026	121,860,900
1994	843	117,213,779			337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996	762	107,751,444			222	22,723,617	984	130,475,061
1997	766	118,344,636			201	21,853,933	967	140,198,569
1998	615	99,224,002	188	\$ 17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000	1,045	185,180,534	1,725	333,328,690	708	92,214,409	3,478	610,723,633
2001	844	135,498,480	1,211	232,445,146	697	101,175,512	2,752	469,119,138
2002 ⁽²⁾	73	12,655,406	72	10,642,694	58	7,551,039	203	30,849,139

(1) Number of new Contracts of Purchase does not include home improvement loans.

(2) 3-month period through September 30, 2001.

**Selected Principal Flows with respect to Contracts of Purchase
Funded by both Veterans G.O. Bonds and Revenue Bonds**

Fiscal Year Ending June 30	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Rate on all Outstanding Contracts	Average of Monthly FHLMC 30-year Conventional Loan Rate	Annual Average Prepayment Rate	Annual Average Origination Rate
Principal Flows					Rates			
1985	\$ 445,131	\$ 123,669	\$ 88,308	\$ 3,142,526	8.0%	13.8%	4.1%	14.7%
1986	404,738	179,809	94,970	3,272,485	8.0	11.5	5.6	12.6
1987	184,627	261,675	99,569	3,095,868	7.7	9.8	8.2	5.8
1988	335,095	198,396	114,178	3,118,389	7.0	10.5	6.4	10.8
1989	335,872	207,471	105,896	3,140,894	7.3	10.6	6.6	10.7
1990	225,596	232,085	96,639	3,037,766	8.0	10.1	7.5	7.3
1991	229,583	191,895	92,722	2,982,732	8.0	9.9	6.4	7.6
1992	146,272	246,150	92,975	2,789,879	8.0	9.0	8.5	5.1
1993	121,861	273,817	105,629	2,532,294	8.0	8.0	10.3	4.6
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9	4.9	6.2
1998	135,811	172,134	94,106	2,098,752	7.7	7.2	8.0	6.3
1999	255,534	183,776	101,254	2,069,256	6.9	6.9	8.8	12.3
2000	610,724	138,401	106,522	2,435,056	6.8	8.1	6.1	27.1
2001	469,119	189,902	91,033	2,623,241	6.8	7.5	7.5	18.5
2002 ⁽¹⁾	30,849	70,399	22,403	2,561,288	6.8	7.0	10.9	4.8
	<u>\$ 4,724,479</u>	<u>\$ 3,394,333</u>	<u>\$ 1,678,231</u>					

Reservation rates on new Contracts of Purchase for period:

Period	Veterans G.O. Bonds*	Unrestricted Funds*	Revenue Bonds*
Prior to January 1, 1999, substantially all newly originated Contracts have the same rate as the then outstanding Contracts.			
January 1, 1999 thru June 30, 2000	6.65%	6.65%	5.95%
July 1, 2000 thru February 28, 2001	7.50%	7.95%	6.95%
March 1, 2001 thru May 31, 2001	6.50%	7.95%	6.40%
June 1, 2001 thru August 31, 2001	6.50%	7.10%	6.40%
September 1, 2001 thru present	6.25%	6.50%	6.00%

* Rates for contracts of purchase for mobile home in parks shall be 1% higher than the applicable established rates.

(1) 3-month period through September 30, 2001.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to become available to fund Contracts of Purchase following the expected Veterans G.O. Bonds and Revenue Bonds issuances described in this Official Statement (the "Winter 2001 Transactions"). The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys is described under "THE PROGRAM--Qualifying Veteran Status." (This section appears in Appendix B in the official statement relating to Veterans G.O. Bonds and in the body of the official statement relating to Revenue Bonds.) Additional moneys may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. As of October 31, 2001, the Department had 266 pending applications for Contracts of Purchase in the aggregate amount of approximately \$40,000,000.

Bond Series	Deposit as of	Balance as of	Respective Series Bond Proceeds Subaccounts			Investment	Investment Rate (%)
			Unrestricted Moneys ⁽¹⁾	Qualified Veterans Mortgage Bond Proceeds ⁽¹⁾	Qualified Mortgage Bond Proceeds ⁽¹⁾		
Veterans G.O. Bond Proceeds Subaccounts							
Series BP.....		9/30/01	-0-	\$ 3,026	-0-	SMIF ⁽³⁾	Variable
Series BJ 11/12.....		9/30/01	-0-	79,613	-0-	AIG ⁽⁸⁾	6.481
Series BT/BU.....		9/30/01	-0-	11,941	-0-	SMIF ⁽³⁾	Variable
Series BV/BW.....		9/30/01	-0-	85,131	-0-	SMIF ⁽³⁾	Variable
Series BX.....		9/30/01	-0-	6,243	-0-	SMIF ⁽³⁾	Variable
Series BY/BZ ⁽¹²⁾	12/6/01		-0-	11,237	-0-	SMIF ⁽³⁾	Variable
Sub-total.....			-0-	\$ 197,191	-0-		
Veterans G.O. Bond Recycling Subaccounts							
Series BM/BN.....		9/30/01	\$ 2,979	-0-	-0-	WestLB ⁽⁵⁾⁽¹¹⁾	5.380
Series BM/BN.....		9/30/01	3,792	-0-	-0-	SMIF ⁽³⁾	Variable
Unrestricted.....		9/30/01	75,081	-0-	-0-	SMIF ⁽³⁾	Variable
Sub-total.....			\$ 81,852	-0-	-0-		
Total Veterans G.O. Bonds			\$ 81,852	\$ 197,191	-0-		
Revenue Bonds Proceeds Subaccounts							
1997 C.....		9/30/01	-0-	-0-	\$ 89,377	Trinity ⁽¹⁰⁾	6.157
2001 A.....		9/30/01	\$ 4,074	-0-	-0-	SMIF ⁽³⁾	Variable
2002 A ⁽¹³⁾	3/6/02		5,904	-0-	-0-	SMIF ⁽³⁾	Variable
Sub-total.....			\$ 9,978	-0-	\$ 89,377		
Revenue Bonds Recycling Subaccounts							
Section 143.....		9/30/01	-0-	-0-	\$ 2,028	Soc Gen ⁽²⁾⁽⁴⁾	5.730
1991 A Recycling.....		9/30/01	\$ 8,362	-0-	-0-	BLB ⁽⁶⁾⁽¹¹⁾	6.060
1999 A/B.....		9/30/01	12,514	-0-	-0-	BLB ⁽⁷⁾⁽¹¹⁾	5.300
2000 A/B/C.....		9/30/01	9,000	-0-	-0-	WestLB ⁽⁹⁾⁽¹¹⁾	6.460
Sub-total.....			\$ 29,876	-0-	\$ 2,028		
Total Revenue Bonds			\$ 39,854	-0-	\$ 91,405		
Grand Total.....			\$ 121,706	\$ 197,191	\$ 91,405		

Footnotes are on the following page.

- (1) 000's omitted.
- (2) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
- (3) Surplus Money Investment Fund. Amounts invested in SMIF may be withdrawn and reinvested at any time.
- (4) Investment agreement maturing December 1, 2001 with Societe Generale.
- (5) Investment agreement maturing December 1, 2028 with Westdeutsche Landesbank Girozentrale.
- (6) Investment agreement maturing December 1, 2009 with Bayerische Landesbank Girozentrale.
- (7) Investment agreement maturing December 1, 2028 with Bayerische Landesbank Girozentrale.
- (8) Investment agreement maturing December 1, 2002 with AIG Matched Funding Corporation ("AIG").
- (9) Investment agreement maturing June 1, 2010 with Westdeutsche Landesbank Girozentrale.
- (10) Investment agreement maturing December 1, 2002 with Trinity Plus Funding Company, LLC ("Trinity"). Under certain circumstances, Trinity will have the benefits of a letter of credit from General Electric Capital Corporation ("GE Capital") and of a revolving liquidity facility under which GE Capital is a lender (there can be additional lenders under the liquidity facility). However, the aggregate of the amounts available under the letter of credit and the liquidity facility may be significantly less than Trinity's obligations under its investment agreements.
- (11) Both S&P and Moody's have announced negative rating outlooks for these banks.
- (12) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Veterans G.O. Bonds as the "Offered Veterans G.O. Bonds" and in the official statement with respect to Revenue Bonds as the "Winter 2001 Veterans G.O. Bonds".
- (13) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".

Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	<u>1994⁽¹⁾</u>	<u>1995⁽¹⁾</u>	<u>1996⁽¹⁾</u>	<u>1997⁽¹⁾</u>	<u>1998⁽¹⁾</u>	<u>1999⁽¹⁾</u>	<u>2000⁽²⁾</u>	<u>2001⁽²⁾</u>	<u>2002⁽³⁾</u>
Percentage of Number of Contracts of Purchase									
Delinquent									
30-60 days ⁽⁶⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	3.27%	3.54%	3.61%
60+ days ⁽⁶⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	2.08%	1.80%	1.54%
Cancelled Contracts and Real Estate in inventory ⁽⁴⁾ ..	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	-- ⁽⁷⁾	0.49%	0.70%	0.61%
USDVA Guaranteed Loans⁽⁵⁾									
Percentages in U.S.									
Delinquent									
30-60 days	4.07%	4.14%	4.59%	4.54%	4.45%	4.35%	4.19%	4.71%	
60+ days	2.25%	2.21%	2.20%	2.21%	2.35%	2.26%	2.25%	2.65%	
Foreclosures in inventory	1.44%	1.26%	1.54%	1.81%	1.77%	1.82%	1.44%	1.20%	
Percentages in California									
Delinquent									
30-60 days	3.42%	4.03%	4.23%	4.30%	4.28%	4.13%	4.05%	4.57%	
60+ days	2.36%	2.53%	2.36%	2.52%	2.61%	2.45%	2.27%	2.49%	
Foreclosures in inventory	2.28%	2.31%	3.18%	3.54%	2.92%	2.28%	1.39%	0.93%	

(1) As of June 18 for Department's and as of June 30 for USDVA data.

(2) As of June 30 for Department's and USDVA data.

(3) As of September 30, 2001 for Department's and as of June 30, 2001 for USDVA data.

(4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.

(5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.

(6) As of the June 30, 1999 installation of the Integrated Loan Processing and Financial Information System, the Department reports delinquencies on a basis consistent with industry standards.

(7) The data below represents the Department's reporting method prior to the implementation of the Integrated Loan Processing and Financial Information System.

	<u>1994⁽¹⁾</u>	<u>1995⁽¹⁾</u>	<u>1996⁽¹⁾</u>	<u>1997⁽¹⁾</u>	<u>1998⁽¹⁾</u>	<u>1999⁽¹⁾</u>
Percentage of Number of Contracts of Purchase						
Delinquent⁽⁷⁾						
40-67 days	0.99%	1.45%	2.90%	1.65%	0.78%	0.87%
68+ days	4.24%	3.12%	2.50%	3.22%	1.99%	1.34%
Cancelled Contracts and Real Estate in inventory ⁽⁴⁾ ..	0.73%	1.28%	1.89%	1.86%	1.49%	0.94%

Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds, including those expected to be redeemed as a result of the issuance Veterans G.O. Bonds and/or Revenue Bonds as part of the Winter 2001 Transactions.

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

<u>Series</u>	<u>Bonds Outstanding as of 8/1/01</u>	<u>Bonds Expected to be Outstanding as of 6/1/02</u>	<u>Final Maturity Date of Series</u>	<u>Next Optional Call Date</u>	<u>Call Price on Such Date</u>	<u>Maximum Coupon Subject to Optional Call</u>	<u>Bonds Subject to Special Redemption⁽⁹⁾</u>
Veterans G.O. Bonds Issued to Refund Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
BM.....	\$ 53,385,000	\$ 53,385,000	December 1, 2025	-- ⁽¹⁾	-- ⁽¹⁾	5.450%	Excess Revenues
BN2-4.....	71,250,000	71,250,000	December 1, 2028	-- ⁽¹⁾	-- ⁽¹⁾	5.450%	Excess Revenues
Sub-total	\$ 124,635,000	\$ 124,635,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AK.....	9,000,000	\$ 7,500,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL.....	26,000,000	20,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM.....	46,000,000	39,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP.....	75,000,000	67,500,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ.....	75,000,000	67,500,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR.....	34,000,000	29,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS.....	38,000,000	37,000,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT.....	165,325,000	150,225,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU.....	113,120,000	103,510,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV.....	77,345,000	70,820,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total	\$ 658,790,000	\$ 592,055,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF ⁽²⁾	\$ 211,245,000	\$ 99,920,000	February 1, 2027	-- ⁽⁴⁾	100%	6.375%	Allocated Prepayments ⁽³⁾
BG/BH.....	586,355,000	584,255,000	December 1, 2032	-- ⁽⁵⁾	-- ⁽⁵⁾	5.600% ⁽⁵⁾	Excess Revenues
BJ7/8.....	60,000,000	60,000,000	December 1, 2032	-- ⁽⁶⁾	-- ⁽⁶⁾	6.200% ⁽⁶⁾	Excess Revenues
BJ9/10.....	40,000,000	40,000,000	December 1, 2032	-- ⁽⁷⁾	-- ⁽⁷⁾	6.050% ⁽⁷⁾	Excess Revenues
BK/BL.....	255,615,000	255,615,000	December 1, 2012	-- ⁽⁵⁾	-- ⁽⁵⁾	5.300% ⁽⁵⁾	Excess Revenues
BP/BN1.....	14,000,000	14,000,000	December 1, 2026	-- ⁽¹⁾	-- ⁽¹⁾	5.500% ⁽¹⁾	Excess Revenues /Unexpended
BQ/BR.....	80,000,000	80,000,000	December 1, 2029	June 1, 2004	101%	5.300%	Excess Revenues
BS.....	26,500,000	26,500,000	December 1, 2008	Non-callable	N/A	N/A	Excess Revenues
BJ11/12 ⁽⁸⁾	115,000,000	115,000,000	December 1, 2032	-- ⁽⁸⁾	-- ⁽⁸⁾	5.700%	Excess Revenues/Unexpended
BT/BU.....	115,400,000	115,400,000	December 1, 2026	December 1, 2005	101%	5.650%	Excess Revenues
BV/BW.....	86,225,000	86,225,000	December 1, 2032	June 1, 2006	101%	5.700%	Excess Revenues /Unexpended
BX.....	42,000,000	42,000,000	December 1, 2032	June 1, 2006	101%	5.500%	Excess Revenues
BY/BZ ⁽¹⁰⁾	--	111,325,000	December 1, 2024	June 1, 2007	101%	5.375%	Excess Revenues /Unexpended
Sub-total	\$ 1,632,340,000	\$ 1,630,240,000					
TOTAL VETERANS G.O. BONDS.....	\$ 2,415,765,000	\$ 2,346,930,000					

<u>Series</u>	<u>Bonds Outstanding as of 8/1/01</u>	<u>Bonds Expected to be Outstanding as of 6/1/02</u>	<u>Final Maturity Date of Series</u>	<u>Next Optional Call Date</u>	<u>Call Price on Such Date</u>	<u>Maximum Coupon Subject to Optional Call</u>	<u>Bonds Subject to Special Redemption⁽⁹⁾</u>
Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code							
1997 A/B	\$ 20,225,000	\$ 19,930,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues
1997 C	97,130,000	94,030,000	December 1, 2019	January 9, 2011	101%	5.500%	Excess Revenues /Unexpended
1998 A	113,690,000	104,110,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues
Sub-total	\$ 231,045,000	\$ 218,070,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A	\$ 54,170,000	\$ 54,170,000	December 1, 2027	June 1, 2004	101%	5.200%	Excess Revenues
1999 B	86,085,000	86,085,000	December 1, 2028	June 1, 2004	101%	5.200%	Excess Revenues
2000 A	54,000,000	--					
2000 B	63,200,000	--					
2000 C	42,600,000	42,600,000	December 1, 2027	June 1, 2005	101%	6.150%	Excess Revenues
2001 A	39,840,000	39,840,000	December 1, 2028	June 1, 2006	101%	5.600%	Excess Revenues /Unexpended
2002 A ⁽¹¹⁾	--	117,200,000	December 1, 2027	June 1, 2012	101%	5.350%	Excess Revenues /Unexpended
Sub-total	\$ 339,895,000	\$ 339,895,000					
TOTAL REVENUE BONDS	\$ 570,940,000	\$ 557,965,000					
TOTAL ALL BONDS ...	\$ 2,986,705,000	\$ 2,904,895,000					

- (1) The Series BM Bonds and Series BN Bonds maturing on and before December 1, 2004 are subject to optional redemption at par on and after June 1, 2000. The remaining Series BM Bonds and Series BN Bonds and all of the Series BP Bonds are subject to optional redemption on and after December 1, 2003, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2004.
- (2) Series BC/BF includes Series BC, Series BD, Series BE and Series BF.
- (3) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series based on periodically determined ratio of outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF is now subject to optional redemption at par.
- (4) The Series BC/BF Bonds are subject to optional redemption prior to their respective stated maturity dates, in whole on the first day of any month, or in part on any interest payment date.
- (5) Except as described in the next sentence, the Series BG Bonds, Series BH Bonds, and Series BL Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are subject to optional redemption on and after December 1, 2003 at 102% of the principal amount thereof, declining to 101% of the principal amount thereof on and after December 1, 2004, and declining further to par on December 1, 2005. The Series BK Bonds are not subject to

optional redemption.

- (6) The BJ-7/8 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on December 1, 2009, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2010. The BJ-7/8 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 1, 2005, initially at 102% of the principal amount thereof, declining to par on and after December 1, 2007.
- (7) The BJ-9/10 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on April 27, 2010, initially at 101% of the principal amount thereof, declining to par on and after April 27, 2011. The BJ-9/10 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on April 27, 2006, initially at 102% of the principal amount thereof, declining to par on and after April 27, 2008.
- (8) The BJ-11/12 Serial Bonds maturing on December 1, 2011 through and including December 1, 2016 are subject to optional redemption on December 19, 2010, initially at 101% of the principal amount thereof, declining to par on and after December 19, 2011. The BJ-11/12 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 19, 2006, initially at 102% of the principal amount thereof, declining to par on and after December 19, 2008.
- (9) Excess Revenues includes principal prepayments.
- (10) Part of the Winter 2001 Transactions, referred to in the official statement with respect to Veterans G.O. Bonds as the "Offered Veterans G.O. Bonds" and in the official statement with respect to Revenue Bonds as the "Winter 2001 Veterans G.O. Bonds".
- (11) Part of the Winter 2001 Transactions, referred to in the official statements with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".

Additional Investments

In addition to the investments described above under "Contracts of Purchase--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and in the Bond Reserve Account which secures the Revenue Bonds. Additional moneys in various Funds and Accounts in the 1943 Fund have been invested in SMIF. Amounts invested in SMIF may be withdrawn and reinvested at any time.

<u>Bond Series</u>	<u>Account Designation⁽¹⁾</u>	<u>Amount (000s)</u>	<u>Investment Provider⁽¹⁾</u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>	<u>Bond Series</u>	<u>Account Designation⁽¹⁾</u>	<u>Amount (000s)</u>	<u>Investment Provider⁽¹⁾</u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>
1997/1998	Reserve	\$5,251 ⁽¹⁷⁾	Societe Generale ⁽³⁾	3/26/98	12/1/28	5.75	BJ 7/8	Revenue/ Recycling	variable ⁽⁸⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	12/1/99	12/1/32 ⁽⁸⁾	6.06
1997/1998	Reserve	\$7,001 ⁽²⁾ ⁽¹⁷⁾	U.S. Treasury	5/8/98	5/15/05	6.50	1991 A	Revenue/ Recycling	variable ⁽⁸⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	12/1/99	12/1/32 ⁽⁸⁾	6.06
1999 A/B	Reserve	\$9,817 ⁽¹⁷⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	3/30/99	12/1/28	5.38	2000 A/B/C ⁽²⁰⁾	Revenue/ Recycling	variable ⁽¹⁰⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	3/29/00	12/1/27 ⁽¹⁰⁾	6.46
2000 A/B/C	Reserve	\$10,186 ⁽¹⁷⁾ ⁽¹⁹⁾	Trinity Plus Funding Company, LLC	4/1/00	12/1/27	6.895	BJ 9/10	Revenue/ Recycling	variable ⁽¹¹⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	4/27/00	12/1/32 ⁽¹¹⁾	6.46
1997 C	Reserve	\$5,733 ⁽¹⁷⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	1/1/01	12/1/19	5.625	BS	Revenue	variable ⁽¹¹⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	4/27/00	12/1/32 ⁽¹¹⁾	6.46
2002 A ⁽¹⁶⁾	Reserve	\$3,759 ⁽¹⁸⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	3/6/02	12/1/27	5.38	BJ 11/12	Revenue/ Recycling	variable ⁽¹²⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/19/00	12/1/32 ⁽¹²⁾	5.50
BG/BH/BK /BL	Revenue/ Recycling	variable ⁽⁴⁾	Societe Generale ⁽³⁾	12/29/97	12/1/32	5.91	BT/BU	Revenue/ Recycling	variable ⁽¹³⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/19/00	12/1/26 ⁽¹³⁾	5.50
1997/1998	Revenue/ Restricted Recoveries	variable	Societe Generale ⁽³⁾	3/26/98	12/1/28	5.91	1997 C	Revenue/ Restricted Recoveries	variable ⁽¹⁴⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	1/9/01	12/1/19	5.50
BM/BN2-4	Revenue/ Recycling	variable ⁽⁵⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	5/5/98	12/1/28	5.38	BV/BW	Revenue/ Recycling	variable ⁽¹⁵⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	6/20/01	12/1/32 ⁽¹⁵⁾	5.67
BP/BN-1	Revenue/ Recycling	variable ⁽⁵⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	5/5/98	12/1/28	5.38	2001 A	Revenue/ Recycling	variable ⁽¹⁵⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	6/20/01	12/1/32 ⁽¹⁵⁾	5.67
1999 A/B	Revenue/ Recycling	variable ⁽⁶⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	3/30/99	12/1/28	5.30	BX	Revenue/ Recycling	variable ⁽¹⁵⁾	Bayerische Landesbank Girozentrale ⁽⁹⁾	6/20/01	12/1/32 ⁽¹⁵⁾	5.67
BQ/BR	Revenue/ Recycling	variable ⁽⁷⁾	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	4/28/99	12/1/29	5.37							

Footnotes are on the following page.

- D-11
- 1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds. All investments are investment agreements unless otherwise noted.
 - 2) At cost. Invested in U.S. Treasury Bonds.
 - 3) On August 18, 1999, Moody's confirmed the long-term rating (senior debt and deposits) of Societe Generale at Aa3 with a negative outlook.
 - 4) Maximum permitted amount on deposit under investment agreement at any one time is \$250,000,000.
 - 5) Maximum permitted amount on deposit under investment agreement for all (BM, BN, and BP) subaccounts is \$50,000,000.
 - 6) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$75,000,000.
 - 7) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$35,000,000.
 - 8) Maximum permitted amount on deposit under investment agreement for all (BJ 7/8, and 1991 A) subaccounts is \$25,000,000. Investment maturity date for the recycling subaccounts is December 1, 2009.
 - 9) Both S&P and Moody's have announced negative rating outlooks for these banks.
 - 10) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$20,000,000. Investment maturity date for the recycling subaccount is June 1, 2010.
 - 11) Maximum permitted amount on deposit under investment agreement for all three (BJ 9/10, and BS) subaccounts is \$20,000,000. Investment maturity date for BJ-9/10 G.O. Bond Series Recycling Subaccount is June 1, 2010.
 - 12) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$25,000,000. Investment maturity date for BJ-11/12 G.O. Bond Series Recycling Subaccount is December 1, 2010.
 - 13) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$20,000,000. Investment maturity date for BT/BU G.O. Bond Series Recycling Subaccount is December 1, 2010.
 - 14) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$97,130,000.
 - 15) Maximum permitted amount on deposit under investment agreement for all (BV/BW, 2001 A, BX) subaccounts is \$25,000,000. Investment maturity date for all (BV/BW, 2001 A, BX) recycling subaccounts is December 1, 2011.
 - 16) Part of the Winter 2001 Transactions, referred to in the official statements with respect to Revenue Bonds as the "Offered Revenue Bonds" and in the official statement with respect to the Veterans G.O. Bonds as the "Winter 2002 Revenue Bonds".
 - 17) As of September 30, 2001.
 - 18) As of March 6, 2002.
 - 19) The amount will be reduced by approximately \$7,471,000 upon the refunding of the 2000 Series A/B Revenue Bonds by the Winter 2002 Revenue Bonds.
 - 20) The 2000 Series A/B Revenue Bonds are to be refunded in whole following the issuance of the Winter 2002 Revenue Bonds.

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APPENDIX E

PROPOSED FORM OF OPINION OF BOND COUNSEL TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS

Set forth below is the proposed form of the opinion of Bond Counsel expected to be delivered in connection with the issuance of the Offered Revenue Bonds.

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

Closing Date

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as bond counsel to the Department of Veterans Affairs of the State of California (the "Department") and in such capacity we have examined upon request copies of proceedings taken by the Department in connection with the issuance of the Department's Home Purchase Revenue Bonds, 2002 Series A (the "Bonds"), in the aggregate principal amount of \$117,200,000, and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted February 24, 1999 (the "Tenth Supplemental Resolution"), and (5) the Fourteenth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$117,200,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, 2002 Series A, adopted November 16, 2001 (the "Fourteenth Supplemental Resolution"). The Resolution of Issuance, the Eighth Supplemental Resolution, the Tenth Supplemental Resolution, and the Fourteenth Supplemental Resolution are collectively referred to herein as the "Resolution."

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolution. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolution.

The State of California issued the Veterans General Obligation Bonds, Series BY and BZ (the "Series BY and BZ Bonds") in December 2001. The Series BY and BZ Bonds and the Bonds are treated as a single issue for certain Federal tax purposes under the Internal Revenue Code of 1986, as amended (the "Code"). Applicable Federal tax law establishes certain requirements that must be met subsequent to the respective issuances of the Series BY and Series BZ Bonds and the Bonds in order that interest on the Bonds not be included in gross income for Federal income tax purposes under the Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The Department has covenanted in the Resolution to at all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for Federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenant and have assumed compliance by the Department with and enforcement by the Department of the provisions of the Resolution and the Program Documents.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

1) Pursuant to the Veterans Act, the Department is empowered to issue the Bonds for the purposes specified in the Resolution, and to pledge the revenues and amounts in the funds and accounts established by the Resolution.

2) The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and represent the legally valid and binding special obligations of the Department, enforceable in accordance with their terms and secured in the manner and to the extent set forth in the Resolution, and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein.

3) The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with its terms.

4) The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment, subject to lawful appropriation, of the principal of and interest on the Bonds of (1) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund"), except proceeds of State veterans general obligation bonds and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of general obligation bonds in the 1943 Fund, created in accordance with any general obligation

veterans bond act, (2) any amounts held in the Bond Reserve Account established pursuant to the Resolution, and (3) any amounts held in the Loan Loss Account established pursuant to the Resolution, which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

5) Under existing statutes and court decisions, and assuming compliance by the Department with certain tax covenants described herein, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. No opinion as to exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Resolution for which action the Resolution requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

6) Under existing law, interest on the Bonds is exempt from State personal income taxation.

With respect to the matters referenced in paragraphs 5 and 6 above, we express no opinion regarding any other Federal or state tax consequences with respect to the Bonds. We render our opinion under existing statutes and court decisions as of the issue date of the Bonds, and assume no obligation to update our opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. We express no opinion on the effect of any action taken after the date of issuance of the Bonds, or not taken, in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state and local tax law.

In rendering this opinion, we are advising you that the enforceability of the Bonds and the Resolution may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

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APPENDIX F

PROPOSED FORM OF OPINION OF THE ATTORNEY GENERAL TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS

Set forth below is the proposed form of the opinion of the Attorney General expected to be delivered in connection with the issuance of the Offered Revenue Bonds.

BILL LOCKYER
Attorney General
State of California
1300 I Street
Sacramento, California 95814

[Closing Date]

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as the Attorney General of the State of California and in such capacity have examined upon request copies of proceedings taken by the Department of Veterans Affairs of the State of California (the "Department") in connection with the issuance of the Department's Home Purchase Revenue Bonds, 2002 Series A (the "Bonds"), in the aggregate principal amount of \$117,200,000, and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted February 24, 1999 (the "Tenth Supplemental Resolution"), and (5) the Fourteenth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$117,200,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, 2002 Series A, adopted November 16, 2001 (the "Fourteenth Supplemental

Resolution"). The Resolution of Issuance, the Eighth Supplemental Resolution, the Tenth Supplemental Resolution, and the Fourteenth Supplemental Resolution are collectively referred to herein as the "Resolution."

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolution. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolution.

We express no opinion as to whether interest on the Bonds is excluded or exempt from gross income for federal income tax purposes or is exempt from State of California personal income taxes, or as to any other tax consequence relating to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in order to render this opinion.

From such examination, we are of the opinion that:

1. Pursuant to the Veterans Act, the Department is empowered to issue the Bonds for the purposes specified in the Resolution and to pledge the revenues and amounts in the funds and accounts established by the Resolution.

2. The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and represent the legally valid and binding special obligations of the Department, enforceable in accordance with their terms and secured in the manner and to the extent set forth in the Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein.

3. The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with its terms.

4. The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment, subject to lawful appropriation, of the principal of and interest on the Bonds of (1) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund"), except proceeds of State veterans general obligation bonds and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of general obligation bonds in the 1943 Fund, created in accordance with any general obligation veterans bond act, (2) any amounts held in the Bond Reserve Account established pursuant to the Resolution, and (3) any amounts held in the Loan Loss Account established pursuant to the Resolution, which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

In rendering this opinion, we advise you that the enforceability of the Bonds and the Resolution may be limited by bankruptcy, insolvency, reorganization, moratorium, arrangement, fraudulent conveyance and other laws relating to or affecting creditors' rights or remedies, to the application of equitable principles (regardless of whether such enforceability is considered in a proceeding in equity or at law), to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California and its subdivisions and departments.

BILL LOCKYER
ATTORNEY GENERAL

By: _____
Deputy Attorney General

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APPENDIX G

CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code restricts the issuance of Federally tax-exempt bonds to finance mortgage loans for single family housing or to refund such bonds.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide Qualified Mortgage Bond Proceeds, (ii) qualified veterans' mortgage bonds, which provide Qualified Veterans' Mortgage Bond Proceeds, and (iii) pre-Ullman bonds, which provide Unrestricted Moneys. Revenue Bonds may be either qualified mortgage bonds or pre-Ullman Bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds.) Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Revenue Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code on Qualified Mortgage Bond Proceeds and Qualified Veterans' Mortgage Bond Proceeds

Qualified Mortgage Bond Proceeds

The Federal Tax Code contains the following loan eligibility requirements with respect to Qualified Mortgage Bond Proceeds, except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Federal Tax Code – Recapture Provision Applicable to Qualified Mortgage Bonds" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of those requirements applies to pre-Ullman bonds or qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the

veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for Federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to finance home improvement loans intended to assure that interest paid on the qualified mortgage bonds is not included in gross income for Federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents," together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of a Contract of Purchase, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Contract of Purchase.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. All financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents state that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas. The Program Documents state that the Department will verify compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to

targeted area residences that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain "high housing cost areas." A high housing cost area is a statistical area for which the ratios of the area's average purchase price for existing and new single family houses to the area's median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirement, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase contain a "due on sale" clause, and the Program Documents state that the assumption of a Contract of Purchase should not be permitted unless these requirements have been met and the appropriate certifications have been obtained.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed \$15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes ("qualified mortgage issue") are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the

veteran's Federal income tax returns for the last three years preceding the date the Contract of Purchase is or was executed even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

Qualified Veterans' Mortgage Bond Proceeds

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under "Qualified Mortgage Bond Proceeds - Residence Requirement," "- New Mortgage Requirement" and "- Qualified Home Improvement Loans" (*except* the \$15,000 maximum loan amount) apply to Qualified Veterans' Mortgage Bond Proceeds.

Other Requirements Imposed by the Federal Tax Code

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans' mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance (or to refund bonds all of such net proceeds of which were used to finance) owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for

owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See "SECURITY FOR AND SOURCES OF PAYMENT OF THE REVENUE BONDS - THE 1943 FUND" and "-THE PROGRAM - Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986 (not including the Offered Revenue Bonds), and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision. The Program Documents include a form of notice and establish procedures to send such notice.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a

\$250,000 *de minimis* amount. As a result, the Department is required by the Federal Tax Code to redeem Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received.

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

APPENDIX H

FORM OF FINANCIAL GUARANTY INSURANCE POLICY

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Financial Guaranty Insurance Policy

Obligor:

Policy Number:

Obligations:

Premium:

Ambac Assurance Corporation (Ambac), a Wisconsin stock insurance corporation, in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to The Bank of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of the Holders, that portion of the principal of and interest on the above-described obligations (the "Obligations") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor.

Ambac will make such payments to the Insurance Trustee within one (1) business day following written notification to Ambac of Nonpayment. Upon a Holder's presentation and surrender to the Insurance Trustee of such unpaid Obligations or related coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Holder the amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Obligations and/or coupons and shall be fully subrogated to all of the Holder's rights to payment thereon.

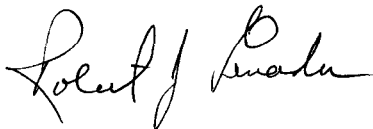
In cases where the Obligations are issued in registered form, the Insurance Trustee shall disburse principal to a Holder only upon presentation and surrender to the Insurance Trustee of the unpaid Obligation, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee duly executed by the Holder or such Holder's duly authorized representative, so as to permit ownership of such Obligation to be registered in the name of Ambac or its nominee. The Insurance Trustee shall disburse interest to a Holder of a registered Obligation only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Obligation and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee, duly executed by the Holder or such Holder's duly authorized representative, transferring to Ambac all rights under such Obligation to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all of the Holders' rights to payment on registered Obligations to the extent of any insurance disbursements so made.

In the event that a trustee or paying agent for the Obligations has notice that any payment of principal of or interest on an Obligation which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from the Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Holder will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

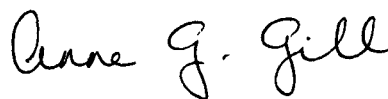
As used herein, the term "Holder" means any person other than (i) the Obligor or (ii) any person whose obligations constitute the underlying security or source of payment for the Obligations who, at the time of Nonpayment, is the owner of an Obligation or of a coupon relating to an Obligation. As used herein, "Due for Payment", when referring to the principal of Obligations, is when the scheduled maturity date or mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Obligations, is when the scheduled date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Obligor to have provided sufficient funds to the trustee or paying agent for payment in full of all principal of and interest on the Obligations which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Obligations prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.



President



Secretary

Effective Date:

Authorized Representative

THE BANK OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Form No.: 2B-0012 (1/01)



Authorized Officer of Insurance Trustee

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